Indiana Law Review

Volume 27 No. 3 1994

Career Move.

No doubt you plan to start a successful legal career soon, so here's a tip:

Start reading *Law Week* now. While you're still in law school.

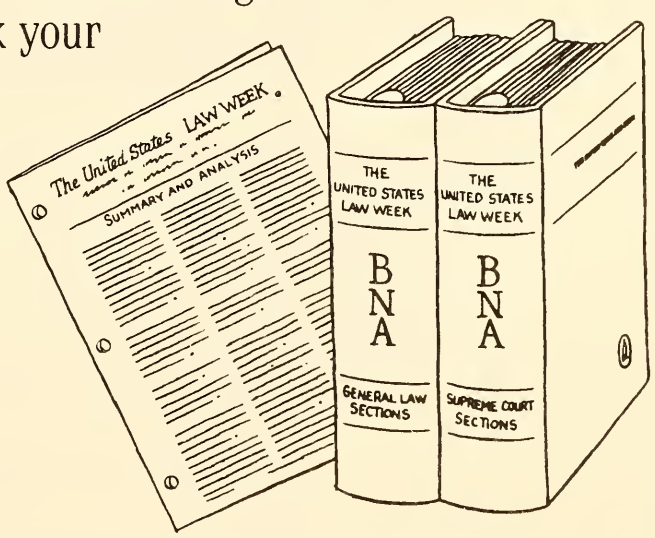
Why? Because top attorneys nationwide read *Law Week* every week, and as you know, it's never a bad idea to follow in the footsteps of the best. But more importantly—

Law Week gives you complete coverage of today's most important cases, with immediate notification of precedent-setting court decisions in every legal field, plus unparalleled Supreme Court reporting.

Indeed, *Law Week* puts *you* on the cutting edge of American law.

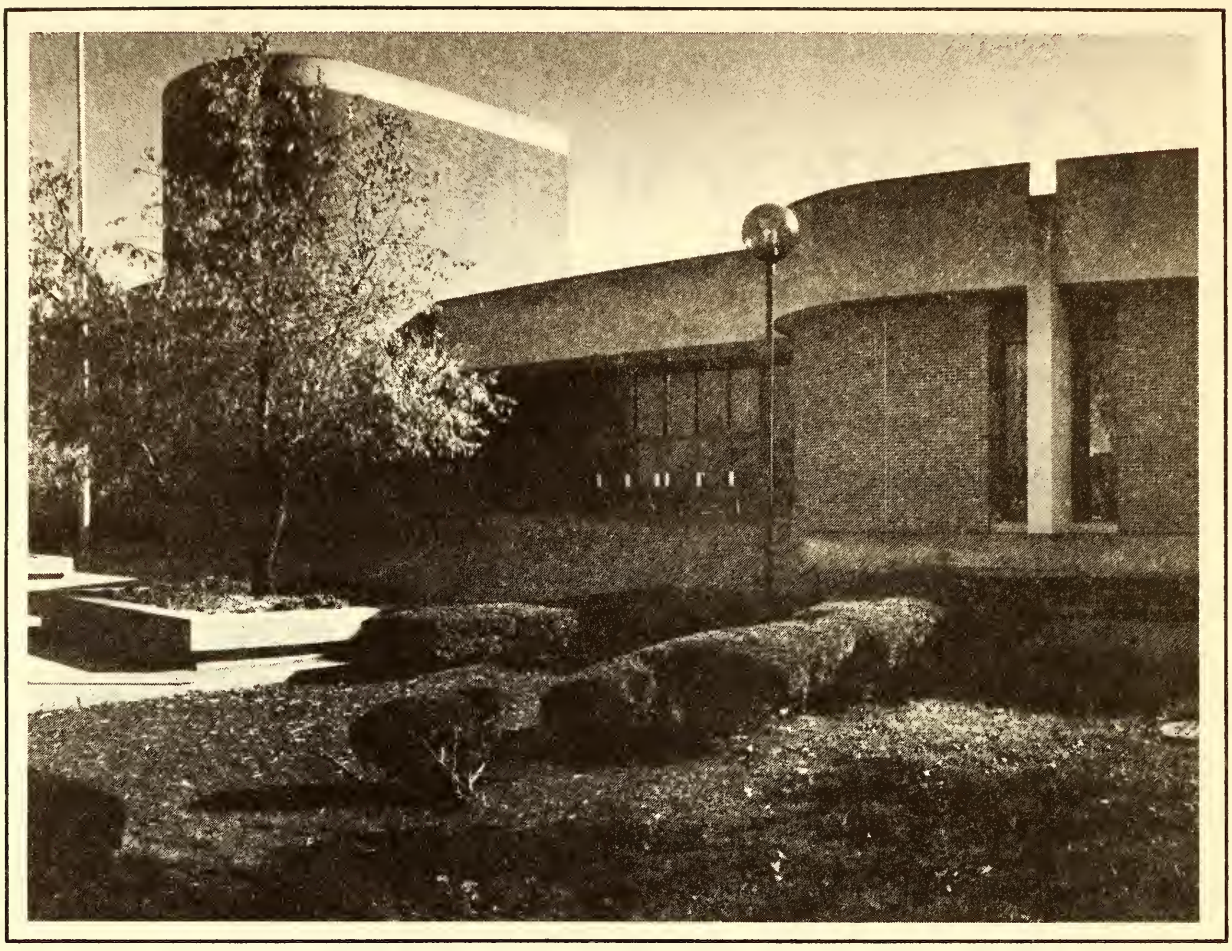
What better way to start a successful legal career.

Make your move now. Ask your professor for details on *Law Week*'s low student rates today.



The Bureau of National Affairs, Inc.
1231 25th Street, N.W.
Washington, D.C. 20037
202/452-4200

The United States
Law Week



Indiana Law Review

Volume 27 1993-94

INDIANA LAW REVIEW

(ISSN 0090-4198)

Published four times a year by Indiana University. Editorial and Business Offices are located at:

Indiana Law Review
735 W. New York Street
Indianapolis, IN 46202
(317) 274-4440

Subscriptions. The current subscription rates are $25.00 per four-issue (domestic mailing) and $28.00 (foreign mailing). Unless the Business Office receives notice to the contrary, all subscriptions will be renewed automatically. Address changes must be received at least a month prior to publication to ensure prompt delivery and must include old and new address and the proper zip code.

Single and Back Issues. Current single regular issues may be obtained from the *Law Review* Business Office for $8.00 Current Survey issues may be purchased for $17.00. Please enclose payment with order. Complete sets and single issues of prior volumes are also available from the *Law Review* Business Office. Unless a claim is made for non receipt of issues within one year of the mailing date, we cannot guarantee supplying the issues without charge.

Manuscripts. The *Indiana Law Review* invites submission of unsolicited manuscripts. All citations should conform to *A Uniform System of Citation* (15th ed. 1991). Manuscripts should be submitted in duplicate and double-spaced with wide margins. The *Indiana Law Review*, as a matter of policy, promotes the use of gender-neutral language, and alternate use of the female or male pronoun is intended to refer to both female and male.

Indiana Law Review

Volume 27 1994 Number 3

TABLE OF CONTENTS

ARTICLES

NOTES

BOOK REVIEW

Volume 27 Number 3

The INDIANA LAW REVIEW (ISSN 0090-4198) is the property of Indiana University and is published quarterly by the Indiana University School of Law—Indianapolis, which assumes complete editorial responsibility thereof. Subscription rates: one year $25; foreign $28. Please notify us one month in advance of any change in address and include both old and new addresses with zip codes to ensure delivery of all issues. Send all correspondence to Editorial Assistant, Indiana Law Review, Indiana University School of Law—Indianapolis, 735 W. New York Street, Indianapolis, Indiana 46202. Publication office: 735 W. New York Street, Indianapolis, Indiana 46202. Second class postage paid at Indianapolis, Indiana 46201.

POSTMASTER: Send address changes to INDIANA LAW REVIEW, 735 W. New York Street, Indianapolis, Indiana 46202.

The entire text of this Law Review is printed on recycled paper.

Indiana University School of Law—Indianapolis

1993-94 ADMINISTRATIVE OFFICERS AND FACULTY

Administrative Officers

THOMAS M. EHRLICH, *President of the University and Professor of Law.* LL.B., Harvard University.

GERALD L. BEPKO, *Vice-President, Indiana University; Chancellor, Indiana University-Purdue University at Indianapolis and Professor of Law.* J.D., IIT/Chicago-Kent College of Law; LL.M., Yale University.

NORMAN LEFSTEIN, *Dean and Professor of Law.* LL.B., University of Illinois; LL.M., Georgetown University.

THOMAS B. ALLINGTON, *Associate Dean for Academic Affairs and Professor of Law.* J.D., University of Nebraska; LL.M., New York University.

JONNA M. KANE, *Assistant Dean for External Affairs and Acting Assistant Dean for Student Affairs.* J.D., Indiana University—Indianapolis.

JONI D. THOMPSON, *Assistant Dean for Development.* M.S., Ball State University.

ANGELA M. ESPADA, *Assistant Dean for Admissions.* J.D., Indiana University—Bloomington.

GEORGE DREMONAS, *Acting Director of Career Services.* J.D., Indiana University—Indianapolis.

Faculty

CYNTHIA M. ADAMS, *Lecturer in Law.* B.A., Kentucky Wesleyan College, J.D., Indiana University—Indianapolis.

THOMAS B. ALLINGTON, *Associate Dean and Professor of Law.* B.A., J.D., University of Nebraska; LL.M., New York University.

EDWARD P. ARCHER, *Professor of Law.* B.M.E., Rensselaer Polytechnic Institute; J.D., LL.M., Georgetown University.

JAMES F. BAILEY, III, *Professor of Law and Director of Law Library.* A.B., J.D., M.A.L.S., University of Michigan.

GERALD L. BEPKO, *Vice President, Chancellor and Professor of Law.* B.S., Northern Illinois University; J.D., IIT/Chicago-Kent College of Law; LL.M., Yale University.

ROBERT BROOKINS, *Associate Professor of Law.* B.S., University of Southern Florida; J.D., Ph.D., Cornell University.

DANIEL H. COLE, *Assistant Professor of Law.* A.B., Occidental College; A.M., University of Chicago; J.D., Lewis and Clark College; J.S.M., Stanford Law School.

PAUL N. COX, *Professor of Law.* B.S., Utah State University; J.D. University of Utah; LL.M., University of Virginia.

CLYDE HARRISON CROCKETT, *Professor of Law.* A.B., J.D., University of Texas; LL.M., University of London (The London School of Economics and Political Science).

DEBRA A. FALENDER, *Professor of Law.* A.B., Mount Holyoke College; J.D., Indiana University—Indianapolis.

DAVID A. FUNK, *Professor of Law.* A.B., College of Wooster; J.D., Case Western Reserve University; M.A., The Ohio State University; LL.M., Case Western Reserve University; LL.M., Columbia University.

PAUL J. GALANTI, *Professor of Law.* A.B., Bowdoin College; J.D., University of Chicago.

HELEN P. GARFIELD, *Professor of Law.* B.S.J., Northwestern University; J.D., University of Colorado.

HAROLD GREENBERG, *Professor of Law.* A.B., Temple University; J.D., University of Pennsylvania.

JEFFREY W. GROVE, *Professor of Law.* A.B., Juniata College; J.D., George Washington University.

WILLIAM F. HARVEY, *Carl M. Gray Professor of Law & Advocacy.* A.B., University of Missouri; J.D., LL.M., Georgetown University.

PAUL T. HAYDEN, *Associate Professor of Law.* B.A., Yale University; J.D., University of California, Los Angeles.

W. WILLIAM HODES, *Professor of Law.* A.B., Harvard College; J.D., Rutgers Newark.

LAWRENCE A. JEGEN, III, *Thomas F. Sheehan Professor of Tax Law and Policy,* A.B., Beloit College; J.D., M.B.A., The University of Michigan, LL.M., New York University.

HENRY C. KARLSON, *Professor of Law.* A.B., J.D., LL.M., University of Illinois.

WILLIAM ANDREW KERR, *Professor of Law.* A.B., West Virginia University; J.D., LL.M., Harvard University; B.D., Duke University.

ELEANOR D. KINNEY, *Professor of Law and Director of the Center for Law and Health.* B.A., Duke University; M.A., University of Chicago; J.D., Duke University; M.P.H., University of North Carolina.

WALTER W. KRIEGER, *Associate Professor of Law.* A.B., Bellarmine College; J.D., University of Louisville; LL.M., George Washington University.

NORMAN LEFSTEIN, *Dean and Professor of Law.* LL.B., University of Illinois; LL.M., Georgetown University.

WILLIAM E. MARSH, *Professor of Law.* B.S., J.D., University of Nebraska.

LYNN A. MCDOWELL, *Clinical Supervisor.* B.S. Indiana University; J.D., Indiana University—Indianapolis.

DEBORAH MCGREGOR, *Lecturer in Law.* B.A., University of Evansville; J.D., Georgetown University.

SUSANAH M. MEAD, *Professor of Law.* B.A., Smith College; J.D., Indiana University—Indianapolis.

MARY H. MITCHELL, *Professor of Law.* A.B., Butler University; J.D., Cornell Law School.

JAMES P. NEHF, *Professor of Law.* B.A., Knox College; J.D., University of North Carolina.

THOMAS R. NEWBY, *Lecturer in Law.* A.B., J.D., Indiana University—Bloomington.

LESLYE A. OBIORA, *Assistant Professor of Law.* LL.B., University of Nigeria; LL.M., Yale Law School; J.S.D. Candidate Stanford Law School.

DAVID R. PAPKE, *Professor of Law and American Studies.* A.B., Harvard College; J.D., Yale University; M.A. in American Studies, Yale University; Ph.D. in American Studies, The University of Michigan.

RONALD W. POLSTON, *Professor of Law.* B.S., Eastern Illinois University; LL.B., University of Illinois.

FRAN QUIGLEY, *Visiting Assistant Professor of Law.* B.A., Hanover College; M.A., Indiana University—Bloomington; J.D., Indiana University—Indianapolis.

JOAN M. RUHTENBERG, *Director of Legal Writing.* B.A., Mississippi University for Women; J.D., Indiana University—Indianapolis.

ANDREW T. SOLOMON, *Lecturer in Law.* A.B., University of Michigan; J.D., Boston University.

KENNETH M. STROUD, *Professor of Law.* A.B., J.D., Indiana University—Bloomington.

JAMES W. TORKE, *Professor of Law.* B.S., J.D., University of Wisconsin.

JOANNE ORR VAN PELT, *Visiting Assistant Professor.* J.D., California Western.

JAMES PATRICK WHITE, *Professor of Law and Consultant on Legal Education to the American Bar Association.* A.B., University of Iowa; J.D., LL.M., George Washington University.

LAWRENCE P. WILKINS, *Professor of Law.* B.A., The Ohio State University; J.D., Capital University Law School; LL.M., University of Texas.

MARY T. WOLF, *Director of Clinical Programs.* B.A., Saint Xavier College; J.D., University of Iowa College of Law.

Emeriti

AGNES P. BARRETT, *Associate Professor Emerita.* B.S., J.D., Indiana University.

CLEON H. FOUST, *Professor Emeritus.* A.B., Wabash College; J.D., University of Arizona.

MELVIN C. POLAND, *Cleon H. Foust Professor of Law Emeritus.* B.S., Kansas State University; LL.B., Washburn University; LL.M., University of Michigan.

R. BRUCE TOWNSEND, *Cleon H. Foust Professor of Law Emeritus.* A.B., Coe College; J.D., University of Iowa.

Law Library Faculty

JAMES F. BAILEY, III, *Professor and Director of Law Library.* A.B., J.D., M.A.L.S., University of Michigan.

MINDE C. GLENN, *Assistant Director for Readers' Services.* B.A., Western Michigan University; M.L.S., Indiana University.

CHRIS E. LONG, *Visiting Catalog Librarian.* B.A., Indiana University; M.A., Indiana University; M.L.S., Indiana University.

MAHNAZ K. MOSHFEGH, *Acquisition/Serials Librarian.* B.A., National University of Iran; M.S., Tehran University; M.A., Ball State University; M.L.S., Ph.D., Indiana University.

KIYOSHI OTSU, *Computer System Specialist and Catalog Librarian.* A.A., Parkland College; A.B., M.S., C.A.S., University of Illinois.

TERENCE L. ROSE, *Reference Librarian.* B.G.S., M.L.S., University of Michigan.

Indiana Law Review

Volume 27 1994 Number 3

ARTICLES

Cooperative Dissent: Dissenting Shareholder Rights in Agricultural Cooperatives

David C. Crago*

Introduction

Corporate law has long recognized the right of dissenting shareholders to obtain the appraisal of their shares upon the occurrence of certain extraordinary events in the life of the corporation.[1] Stock holders in agricultural cooperatives,[2] however, have consistently been denied this protection. Although courts[3] and commentators[4] have asserted several justifications for different treatment of cooperative shareholders, none of the arguments sufficiently distinguish corporate cooperatives from other corporate forms of business so as to justify denying their shareholders the same protection available to all other shareholders. There is no analytical basis for treating cooperative corporations differently from other corporations. Thus, shareholders in cooperatives should be able to obtain appraisal of their shares under the same circumstances that trigger appraisal rights in other corporations.

---

* Assistant Professor of Law, Ohio Northern University. A.B., 1974, Duke University; J.D., 1977, University of Michigan. I wish to thank my research assistants for 1992-93, Amy Austin, Jeff Buckley and Kim Wyss, for their diligence and effort.

1. All jurisdictions grant dissenters' rights in merger situations. Other transactions which generally trigger appraisal rights are compulsory share exchanges, the sale or exchange of assets other than in the regular course of business, and when certain enumerated amendments to the articles are adopted. Joel Seligman, *Reappraising the Appraisal Remedy*, 52 Geo. Wash. L. Rev. 829, 831-33 (1984) (footnotes omitted).

2. Cooperatives can be organized either as a corporation or an unincorporated association. The analysis contained in this article is limited to corporate cooperatives. Many variations on equity investment, however, have been developed by cooperatives. *See* Terence J. Centner, *Cooperatives: A Search for Equitable Relief from the Equity Redemption Problem*, 7 J. of Agric. Tax'n & L., 120, 136-38 (1985).

3. *See, e.g.*, Pearson v. Clam Falls Coop. Dairy Ass'n, 10 N.W.2d 132 (Wis. 1943); Weise v. Land O'Lakes Creameries, Inc., 191 N.W.2d 619 (Iowa 1971) (dictum); Denes v. Countrymark, Inc., 580 N.E.2d 1135 (Ohio Ct. App. 1989).

4. Kathryn J. Sedo, *Cooperative Mergers and Consolidations: A Consideration of the Legal and Tax Issues*, 63 N.D. L. Rev. 377, 397-400 (1987).

I. THE STRUCTURE OF CORPORATE COOPERATIVES

Cooperatives began as creatures of state law[5] and remain so today.[6] Initially, cooperatives were viewed as implementing farmers' drive of working together to benefit all members.[7] Many of the early promoters of cooperatives viewed them as "small groups of growers who are neighbors, who have confidence in one another, [and] who belong to the same churches, schools, or other neighborhood institutions."[8] To these apostles of cooperation, this form of business represented more a way of life than an economic entity.

> The cooperative movement does not represent a business system alone though it must, of course, develop the highest form of business efficiency to justify its continuance. It involves, also, a very intimate, human quality whose roots are deeply implanted in the social nature of men, and whose expression leads them to work willingly and unselfishly together.[9]

This understanding of cooperatives led to the adoption of several federal statutes designed to encourage cooperatives' growth and give them special protection.[10]

Today, cooperatives are large and sophisticated. Instead of "the small local farmer organizations generally prevalent in the 1920's, many cooperatives have evolved and consolidated into large regional, national, and international business organizations."[11] The largest agricultural cooperatives now exceed $1 billion in annual sales,[12] and frequently engage in complex business

---

5. *See, e.g.*, Mass. St., 1866, c. 290; Pa. Public Laws 1868, Act. 62; Ohio Laws, 1884, p. 54; Kansas, Laws 1887 c. 116; Raymond J. Mischler, *Agricultural Cooperative Law*, 30 Rocky Mtn. L. Rev. 381, 381-83 (1957).

6. James R. Baarda, U.S. Dep't of Agric., Cooperative Principles and Statutes, ACS Rep't 30, at 5-9; 15-18 (1986). For a brief synopsis of federal statutory efforts to encourage cooperatives, *see* Wendy Moser, *Selective Issues Facing Cooperatives: Can the Customer Continue to be the Company?*, 31 S.D. L. REV. 394, 395-96 (1986).

7. Frost v. Corporation Comm'n of Oklahoma, 278 U.S. 515, 536-37 (1929) (Brandeis, J. dissenting).

8. National Agricultural Conference, H.R. Doc. No. 195, 67th Cong., 2d Sess. 79 (1922).

9. *Id.* at 78.

10. Terence J. Centner, *Legislative Provisions for Agricultural Cooperatives: Adjusting to Changed Circumstances*, 33 Drake L. Rev. 325, 325-27 (1984). *See also* Fairdale Farms, Inc. v. Yankee Milk, Inc., 635 F.2d 1037, 1040-44 (2nd Cir. 1980), *cert. denied*, 454 U.S. 818 (1981), *and cert. denied*, 464 U.S. 1043 (1984).

11. Centner, *supra* note 10, at 327.

12. At least a dozen agricultural cooperatives were included in a *Fortune* article on the 500 largest industrial corporations in the United States. *Fortune's 500 Largest U.S. Industrial Corporations*, Fortune, April 20, 1992, at 212-42. All twelve of these cooperatives had sales in excess of $500 million with the four largest (Farmland Industries: $3.652 billion; Agway $3.490 billion; Land O'Lakes: $2,458 billion; and Mid-America Dairymen $1.742 billion) exceeding one and a half billion dollars in sales.

arrangements with non-cooperative corporations.[13] Much of this growth has been the result of mergers and acquisitions of other cooperatives.[14] With vast amounts of equity,[15] large market shares,[16] and professional management, today's cooperatives are quite similar to other corporations.[17]

A cooperative is, in its broadest sense, merely a voluntary "organization designed to carry on any lawful business for the benefit of its members."[18] Because most cooperatives are organized as corporations, they can only be distinguished from other corporations by virtue of certain operating concepts.[19] The principles most commonly thought to distinguish corporate cooperatives from other corporations are: (1) democratic control by members, (2) "non-profit" nature, and (3) returns based on patronage, not investment.[20]

---

13. *See* Myron J. Fleck, *Cooperatives—Accounting and Tax Developments*, 11 J. of Agric. Tax'n & L. 86 (1989); John D. Reilly, *An Overview of the Use of Subsidiaries by Agricultural Cooperatives*, 13 J. OF AGRIC. & TAX'N & LAW 197 (1991).

14. The process of consolidation has been ongoing for several decades. *See* Mischler, *supra* note 5, at 383. The number of cooperatives have been steadily declining while their business volume has been steadily increasing. The total number of marketing, farm supply, and related service cooperatives declined from 6,211 in 1981 to 4,663 in 1990. Agricultural Cooperative Service, U.S. Dep't of Agric., 1990 Farmer Cooperative Statistics 4-5 (1991).

15. Robert C. Rathbone, U.S. Dept. of Agric., Cooperative Financing and Taxation, ACS Report 1, § 9, at 3-4 (1991). In 1990, the combined net worth, or member and patron equity, of farmer cooperatives exceeded $13 billion. AGRICULTURAL COOPERATIVE SERVICE, *supra* note 14, at 43.

16. *See, e.g.*, Alexander v. National Farmers Org., 687 F.2d 1173, 1192 (8th Cir. 1982), *cert. denied*, 461 U.S. 937 (1983); *Fairdale Farms, Inc.*, 635 F.2d at 1041. Indeed, the creation of large market shares for cooperatives has been viewed by some courts as both a goal of government policy and as a necessity by cooperatives. *Id.* at 1040-44. The effect of this growth in market share, however, can be the creation of oligopolistic markets where agricultural producers have little choice but to use cooperatives. Centner, *supra* note 2, at 123.

17. Douglas Fee & Allan C. Hoberg, *Potential Liability of Directors of Agricultural Cooperatives*, 37 Ark. L. Rev. 60, 61 (1984).

18. *General Principles and Problems of Cooperatives: An Introduction*, 1954 Wis. L. Rev. 533; *see also* FARMER COOPERATIVE SERVICE, U.S. DEPT. OF AGRICULTURE, LEGAL PHASES OF FORMER COOP., at 2 (1976).

19. Mischler, *supra* note 5, at 383; *General Principles and Problems*, *supra* note 18, at 534; some of the large cooperatives have "emasculated" these cooperative principles. Centner, *supra* note 10, at 327. The diminished significance of these principles in today's cooperatives has been cause for alarm among some observers. *See* Neil D. Hamilton, *Cooperative Member Relations and Members' Rights in Retained Equity—Setoffs and Other Approaches*, 6 J. of Agic. Tax'n & L. 603, 620 App. A (1984). To the extent that these organizations ignore these principles, the entity is indistinguishable from other types of corporations and there can be no justification for denying appraisal rights.

20. Mischler, *supra* note 5, at 383; Mary Beth Matthews, *Recent Developments in the Law Regarding Agricultural Cooperatives*, 68 N.D. L. Rev. 273 (1992); RICHARD L. KOHLS & JOSEPH N. UHL, MARKETING OF AGRICULTURAL PRODUCTS 226 (7th ed. 1985). Henry W. Ballantine, *Cooperative Marketing Associations*, 8 MINN. L.R. 1, 4 (1923). The Internal Revenue Service has also focused on these criteria to define corporations that are "operating on a cooperative basis" so

These operating principles, however, do not change the fundamental corporate nature of a cooperative organized with capital stock.[21]

Corporate cooperatives are organized as any other corporation.[22] Each cooperative has a board of directors, officers, and employees who handle the cooperative's business affairs. Cooperatives' capital structure generally includes both voting and non-voting common stock.[23] As in other corporate enterprises, holders of voting stock vote on a board of directors.[24] In cooperatives, the board of directors make all decisions as to matters of policy and as to any substantial matter outside the routine affairs of the cooperative.[25] The stockholders of a cooperative have little or involvement with the day-to-day management of the cooperative.[26]

Not only are cooperative corporations structured as other corporations, they are also generally treated as general corporations for purposes of

---

as to allow it to take advantage of favorable tax treatment of its earnings. I.R.C. § 1381(a)(2) (1992) and Treas. Reg. § 1.521-1 (1965). *See generally* Reilly, *supra* note 13, at 202-05; Robert J. Lamont, *Farmers' Cooperatives: Obtaining and Maintaining the Tax Exempt Status of Section 521*, 53 N.D. L. REV. 519 (1977).

21. Schoenburg v. Klappernick, 300 N.W. 237, 239 (1941).

22. State laws regulating the organization of cooperatives lack the general uniformity present in most state corporation statutes. *See* Centner, *supra* note 10, at 330-32. In 1936 a "Uniform Agricultural Cooperative Association Act" was adopted the Commissioners on Uniform State Laws. The Act received little acceptance and was withdrawn seven years later. Handbook of the National Conference of Commissioners on Uniform State Laws 289-309 (1936); HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 66 (1943). The incorporation of the general corporation law by most state cooperative statutes, however, minimizes this problem of lack of uniformity to some extent. *See infra* note 42 and accompanying text.

23. Wisconsin's cooperative statute exemplifies the typical capital stock provisions:

> (2) A cooperative organized with capital stock may issue the amount of stock stated in its articles. Such stock may be divided into 2 or more classes with such designations, preferences, limitations, and relative rights as shall be stated in the articles, except that:
>
> (a) Stock as such has no voting power . . . ;
>
> (b) Stock without par value shall not be authorized or issued;
>
> (c) The rate of dividends upon stock shall not exceed 8% of its par value for any year, but dividends may be cumulative.

Wis. Stat. Ann. § 185.21(2) (West 1992).

24. Shareholders in the cooperative elect the board of directors, who manage the corporation by determining corporate policy and appointing officers to execute such policy. Separation of ownership (in the shareholders) and management (in the board of directors and officers), is inherent the management structure of a corporation. Noble v. Farmers Union Trading Co., 216 P.2d 925, 929 (Mont. 1950).

25. Israel Packel, The Organization and Operation of Cooperatives 129 (4th ed. 1970).

26. *Id.* at 116; Terence J. Centner, *Retained Equities of Agricultural Cooperatives and the Federal Securities Acts*, 31 U. Kan. L. Rev. 245, 270 (1983).

corporate law. For example, cooperative stockholders can bring derivative actions on behalf of the corporation, subject only to the statutory requirements for such actions.[27] Officers and directors of cooperatives are subject to the same fiduciary standards imposed on other corporate officers.[28] In other words, despite the distinctive operating principles of cooperatives, the rules, rights, and duties of shareholders, officers, and directors have been understood to be governed by the same principles applicable to all corporations.

Cooperatives frequently limit both the amount of voting stock that can be held by any one person and the holder's ability to transfer the stock.[29] This limitation allows cooperatives to retain a semblance of the "one member—one vote" notion that permeated early cooperatives.[30] Regardless of this limitation, in the use of voting and non-voting common stock to effect control cooperatives are no different than many other corporations.[31]

Many cooperatives issue preferred stock. Preferred stock is usually non-voting and may be held by anyone, whether a member or non-member.[32]

---

27. *See* Clinton Hudson & Sons v. Lehigh Valley Coop. Farms, Inc., 73 F.R.D. 420, 428-29 (E.D. Pa., 1977); Parish v. Maryland and Virginia Milk Producers Ass'n, Inc., 242 A.2d 512, 538-46 (Md. Ct. App., 1968), *aff'd after remand*, 277 A.2d 19, 48 (Md. Ct. App. 1971), *cert. denied*, 404 U.S. 940 (1971); Fee & Hoberg, *supra* note 17, at 104-05. The statutes of some states allow both member and non-member stockholders to bring derivative actions on behalf of the cooperative. *See, e.g.*, Wis. Stat. Ann. § 185.93 (West 1992).

28. *Parish*, 277 A.2d at 48. Matthews, *supra* note 20, at 275; Fee & Hoberg, *supra* note 17, at 63-75. This result is frequently achieved by means of the incorporation of the general corporation statute into the state's cooperative legislation. Centner, *supra* note 10, at 346 n.127; Matthews, *supra* note 20, at 275.

29. Packel, *supra* note 25, at 30. Voting and transfer restrictions are sometimes mandated by statute. *See, e.g.*, WIS. STAT. ANN. § 185.21(3)(a) (West 1992); IOWA CODE ANN. §§ 499.22, 499.28 (West 1991). N.D. CENT. CODE § 10-15-20(2) (1985). Limitations on the transferability of stock, however, do not distinguish cooperatives from other corporations. *Compare* DEL. CODE ANN. tit. 8, §§ 202, 342 (1991).

30. Henry H. Bakken, *Principles and Their Role in the Statutes Relating to Cooperatives*, 1954 Wis. L. Rev. 549, 554-56. This concept of member democracy, however, has steadily eroded with the growth of cooperatives. KOHLS & UHL, *supra* note 20, at 237-38.

31. *Compare* Del. Code Ann. tit. 8 § 151(a) (1991). Although typically used by closely held companies to effectuate control agreements, the use of non-voting stock became a common takeover defense during the 1980's. Such stock has been issued by a variety of the nations largest companies. *See generally* Exchange Act Release Nos. 25891 and 25891A Fed. Sec. L. Rep. (CCH) ¶ 84,247, at 89,215-217 (1988).

32. Farmer Cooperative Service, *supra* note 18, at 31; The provisions of the Iowa statute are indicative of the general status of cooperative law:

> Preferred stock shall bear cumulative or noncumulative dividends as fixed by the articles, not exceeding eight percent per annum. It shall have no vote. It shall be issued and be transferable without regard to eligibility or membership, and be redeemable on terms specified in the articles and as provided for in this chapter. The directors shall determine the time and amount of its issue.

Although some observers have asserted that a cooperative must be wholly owned by its members,[33] the ability to issue non-voting common or preferred stock permits the cooperative to acquire capital from investors outside the cooperative's membership.[34] The issuance of non-membership stock permits cooperatives to raise capital based on investment motives instead of patronage.[35]

While the management structure of cooperative corporations is similar to other corporations, cooperatives can avail themselves of several capital raising methods unavailable to non-cooperative corporations. In addition to selling stock directly to members and outside investors, cooperatives frequently "sell" equity to members instead of returning them cash.[36] Capital is largely accumulated by retaining a portion of the cooperative earnings.[37] These net proceeds become dividends, a large percentage of which, instead of being paid out in cash, are retained by the cooperative in order to increase capital.[38] The retained equity reflects the patron's ownership interest in the cooperative. This system of raising equity capital creates three possible types of cooperative shareholders: (1) members; (2) patrons; and (3) investors.[39] An individual may play one, or any combination of these roles within a cooperative corporation.[40] However, each of these relationships imposes its own obligation on the cooperative.[41]

II. Appraisal Rights Within the Corporate Context

The majority of state statutes authorizing the creation of cooperatives incorporate the state's corporation law for cooperatives organized with capital stock.[42] Included within these general corporation statutes are the provisions

---

Iowa Code Ann. § 499.24 (West 1991). A few states allow the use of voting preferred. *See, e.g.*, GA. CODE ANN. §§ 2-10-91(e) (Michie 1990).

33. *General Principles and Problems of Cooperatives: An Introduction*, *supra* note 18, at 536.

34. Indeed this was the purpose of much of the federal legislation dealing with cooperatives. *See infra* notes 132-35 and accompanying text.

35. *Compare* Reves v. Ernst & Young, 494 U.S. 56. 66-70 (1990) *with* B. Rosenberg & Sons, Inc. v. St. James Sugar Coop., Inc., 447 F. Supp. 1, 3-4 (E.D. La. 1976), *aff'd*, 565 F.2d 1213 (5th Cir. 1977), *cert. denied*, 112 S. Ct. 1165 (1992).

36. Note, *The Patronage Refund*, 35 Minn. L. Rev. 549, 551 (1951).

37. Centner, *supra* note 2, at 121; Matthews, *supra* note 20, at 274.

38. J. W. Looney et al., AGRICULTURAL LAW 468-69 (A.B.A. 1970). Centner, *supra* note 2, at 122. These retained equities may be evidenced by a variety of instruments including capital stock. I.R.C. § 1388(b) (1992); Centner, *supra* note 2, at 134.

39. Charles E. Nieman, *Multiple Contractual Aspects of Cooperatives' By-Laws*, 39 Minn. L. Rev. 135, 139-48 (1955); Mischler, *supra* note 5, at 383.

40. Nieman, *supra* note 39, at 147.

41. *Id.* at 139-48.

42. Sedo, *supra* note 4, at 380; Centner, *supra* note 2, at 121-22; Mischler, *supra* note 5, at 385; Matthews, *supra* note 20, at 304-05.

for appraisal rights on the part of dissenting shareholders.[43] Although the events giving rise to the right to an appraisal vary widely among the statutes,[44] every state provides this remedy for certain enumerated events.[45]

Dissenters' rights developed as a means of resolving the conflict between the need for corporate management to have the ability to engage in transactions affecting both the nature and character of the corporation and the early common law rule that "unanimous shareholder consent was a prerequisite to fundamental changes in the corporation."[46] The common law view was predicated upon the belief that the corporate charter was contractual in nature and that a merger or other fundamental change, without unanimous shareholder approval, constituted a contract modification without the shareholder's consent.[47] The law assumed "that the stockholder had purchased a portion

---

43. Only four states expressly provide appraisal rights for dissenting cooperative shareholders. *See* Iowa Code Ann. § 499.65 (West 1991); MONT. CODE ANN. § 35-16-211 (1991); UTAH CODE ANN. § 3-1-39 (1988); VERMONT STAT. ANN. tit. 11, § 1061 (1984). In all other states, dissenting shareholder rights must be gleaned from the general corporation laws. Several states do provide for appraisal of a member's equity interests upon withdrawal from the cooperative. *See, e.g.*, COLO. REV. STAT. §§ 7-55-103 (1986); KAN. STAT. ANN. § 17-1609 (1988). Even these statutes, however, have been interpreted to make payment of the value of the member's stock discretionary with the board of the cooperative. *See* Claassen v. Farmers Grain Coop., 490 P.2d 376, 380 (Kan. 1971). These statutes also often provide that the *board* determines the value of the equity. Moreover, they explicitly only apply to members. As a result, persons who are only patrons or investors (*See* Nieman, *supra* notes 39-41 and accompanying text) are excluded from these statutes' protection.

44. One commentator recently summarized the status of appraisal statutes by concluding "[t]here are almost as many varieties of appraisal statutes as jurisdictions." Hideki Kanda & Saul Levmore, *The Appraisal Remedy and the Goals of Corporate Law*, 32 UCLA L. Rev. 429, 430 (1985). *See also* Stephen H. Schulman & Alan Schenk, *Shareholders' Voting and Appraisal Rights in Corporate Acquisition Transactions*, 38 BUS. LAW. 1529 (1983). The mechanics for asserting the claim also vary from state to state. For a review of the procedure under the RMBCA *see* Henry F. Johnson & Paul Bartlett, *Is a Fistful of Dollars the Answer? A Critical Look at Dissenters' Rights Under the Revised Model Business Corporation Act*, 12 J.L. & COM. 211, 216-21 (1993).

45. Seligman, *supra* note 1, at 831-33 (1984). All states provide some version of appraisal for dissenting shareholders upon a merger. Additionally, nearly all of the states provide for appraisal upon the sale of all or substantially all of the corporation's assets. Half the states also make the remedy available for certain charter amendments. ALI, Principles of Corporate Governance 950-51 (Final Draft, March 1992); *see generally* 12B WILLIAM M. FLETCHER, FLETCHER CYCLOPEDIA OF CORPORATIONS § 5906.20 (Rev. Vol. 1993). *Compare* Rev. Model Bus. Corp. Act §§ 13.01-13.31 (1993).

46. Voeller v. Neilston Warehouse Co., 311 U.S. 531, 535 n.6 (1941). The requirement of unanimous shareholder consent persisted in some states until late in the nineteenth century. *See* People v. Ballard, 32 N.E. 54, 59-60 (N.Y. 1892).

47. William J. Carney, *Fundamental Corporate Changes, Minority Shareholders, and Business Purposes*, 1980 A.B.F. Res. J. 69, 78-79. Elliott J. Weiss, *The Law of Take Out Mergers: A Historical Perspective*, 56 N.Y.U. L. REV. 624, 626-30 (1981). Whether this development was thought to be constitutionally mandated is a matter of debate. *Compare* Manning, *infra* note 55,

of a going concern, and his approval was necessary to divest him of that which he had purchased."[48]

While clearly protecting minority interests, the need for unanimous shareholder action created the potential for minority shareholders to extract large premiums for their stock by arbitrarily refusing to approve proposed transactions.[49] Moreover, a single shareholder, who for any reason (no matter how capricious) decided to oppose a transaction and who refused to sell his stock, could block the corporate action regardless of how beneficial it might be to the corporation. The common law rule thus created enormous tension between a corporation's need to respond to changing business circumstances and the sometimes arbitrary or greedy wishes of stockholders.

Initially, courts resolved this conflict by allowing a common law recovery of the value of stock to shareholders who opposed a transaction favored by the majority.[50] In addition, legislatures responded by creating statutory appraisal rights.[51] This genesis of dissenters' rights was summarized recently by the Delaware Court of Chancery:

> An appraisal is method of paying a shareholder for taking his property. It is a statutory means whereby the shareholder can avoid the conversion of his property into other property not of his choosing. The statutory right is given the shareholder as compensation for the abrogation of the common law rule that a single shareholder could block a merger.[52]

By the 1930's, appraisal statutes had become common place in the United States.[53]

---

at 246-47 *with* EISENBERG, *infra* note 51, at 75-76.

48. Armstrong v. Marathon Oil Co., 513 N.E.2d 776, 782 (Ohio 1987). Fletcher, *supra* note 45, at § 5906.10.

49. *Voeller*, 311 U.S. at 535 n.6; Lynn A. Stout, *Are Takeover Premiums Really Premiums? Market Price, Fair Value, and Corporate Law*, 99 Yale L.J. 1235, 1285 (1990).

50. Lauman v. Lebanon Valley R.R. Co., 30 Pa. 42, 45-46 (1858); State v. Bailey, 16 Ind. 46, 51-52 (1861); International & G.N.R.R. Co. v. Bremond, 53 Tex. 9, 119 (1880). Pennsylvania apparently still retains a common law right of appraisal in circumstances not covered by statute. Troupianksy v. Henry Disston & Sons, Inc., 151 F. Supp. 609, 611 (E.D.Pa. 1957).

51. Statutory appraisal provisions seem to have been first adopted by the Ohio legislature in the early 1850's. Melvin Aron Eisenberg, The Structure of the Corporation 75 (Little Brown 1976).

52. Francis I. DuPont & Co. v. Universal City Studios, Inc., 343 A.2d 629, 634 (Del. Ch. 1975) (citations omitted). *Accord* Solomon Bros., Inc. v. Interstate Bakeries Corp., 576 A.2d 650, 652 (Del. Ch. 1989).

53. Irving J. Levy, *Rights of Dissenting Shareholders to Appraisal and Payment*, 15 Cornell L. Rev. 420, 421 (1930). The remedy, however, is not limited to the United States. For example, dissenting shareholders of Canadian corporations are entitled to an appraisal of their shares upon a wide range of corporate transactions. *See* Deborah A. DeMott, *Oppressed but Not Betrayed: A Comparative Assessment of Canadian Remedies for Minority Shareholders and Other Corporate Constituents*, 56 LAW & CONTEMP. PROBS. 181, 187-88 n.24 (Winter 1993).

Despite this long-standing recognition of appraisal rights, these statutes have been criticized.[54] Professor Manning, in a well-known article, began this assault.[55] Although he accepted the historical understanding of the development of appraisal statutes, he challenged the effectiveness of the statutes to implement the policies they purport to reflect.[56]

These criticisms led to efforts to scale back the availability of appraisal actions. The principal change was the enactment of "stock market exception" provisions to appraisal statutes.[57] Accepting the premise that a legally created market for dissenting shareholders is unnecessary where an actual trading market in the shares exists,[58] legislatures exempted dissenting shareholders in corporations listed on national exchanges from the coverage of the appraisal statutes.[59]

Both critics and advocates of appraisal statutes, however, have consistently recognized their utility in corporations without an active market for securities.[60] Shareholders in these types of corporations are not only particularly susceptible to abuse by the majority, but they frequently become shareholders for reasons unrelated to investment. Unlike investors in publicly traded companies, these shareholders become participants in a particular enterprise, not mere investors seeking the highest return on their investment.[61] In this

---

54. *See generally* Kanda & Levmore, *supra* note 44. Cyril Moscow, *Aspects of Shareholder Rights*, 18 Wayne L. Rev. 1003, 1023 (1972) ("appraisal rights do not protect anyone who needs protection") (footnote omitted).

55. Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 Yale L.J. 223 (1962).

56. *Id.* at 260-62. The specific goals and supporting rationale of appraisal actions remain the subject of scholarly debate. *See* Stout, *supra* note 49, at 1287 nn.284-86. Within the context of cooperatives, however, the traditional rationale is particularly applicable. *See infra* notes 81-82.

57. Note, *A Reconsideration of the Stock Market Exception to the Dissenting Shareholder's Right of Appraisal*, 74 Mich. L. Rev. 1023, 1031-32 (1976).

58. Manning, *supra* note 55, at 261; Stout, *supra* note 49, at 1286.

59. In 1969 the Model Business Corporation Act was amended to eliminate appraisal rights when the shares were listed on a national exchange. Several states adopted this change, but in 1978 the drafters reversed their field and deleted this exception. The change resulted from the recognition that the stock market was an imperfect indicator of value. Alfred F. Conard, *Amendments of Model Business Corporation Act Affecting Dissenters' Rights*, 33 Bus. Law. 2587, 2595 (1978); Stout, *supra* note 49, at 1286-89. Today, shareholders in all but the largest corporations retain their right to appraisal. *See, e.g.*, DEL. CODE ANN. tit. 8, § 262(b) (1991).

60. Manning, *supra* note 55; Eisenberg, *supra* note 51, at 79. Critics have concluded that "[t]he soundest view of appraisal rights is that they are a guarantee of liquidity of minority shareholders' investments in the event of major corporate changes, not a guarantee of values for shares." Moscow, *supra* note 54, at 1027. This guarantee is particularly appropriate when no market is available for the shares. Recent analysts have also concluded that appraisal rights add value to stock of public companies as well as protect minority shareholders in those corporations. Daniel R. Fishel, *The Appraisal Remedy in Corporate Law*, 1983 A.B.F. RES. J. 875.

61. Revised Model Business Corp. Act, Close Corp. Supp. § 11, Official Comment (1993).

regard cooperatives are analogous to privately held corporations. Although cooperatives generally have more members than a close corporation, both types of entities usually limit shareholder eligibility, frequently limit voting rights, and restrict the transfer of shares.[62] Not only is there little or no market for the stock of agricultural cooperatives, but the member/patron stockholders generally allow a particular entity to use their capital because of the stockholder's relationship with the cooperative. Absent an appraisal mechanism, stockholders who no longer desire to support the cooperative, because of a transaction working a fundamental change in its operations, have no way to recover their capital. While the individuals may cease to be members or patrons, this change in status has little effect since the cooperative retains their investment.[63]

Although some states have restored appraisal rights to shareholders of public as well as private corporations,[64] this restoration has come with a price. The appraisal remedy has come to be viewed as the exclusive remedy for shareholders who dissent from the action of the majority.[65] Absent very flagrant conduct by insiders which taints the entire transaction with fraud or self-dealing, courts have viewed the options available to dissenters as limited: seek appraisal or go along with the majority.[66]

The rationale for making appraisal a dissenter's exclusive remedy can be traced back to the origin of the appraisal statutes. As noted earlier, the statutes were adopted to allow corporations to engage in a variety of transactions without being subject to the views of a single or small number of shareholders. If shareholders were allowed to continue to seek other remedies (principally injunctions), then a primary purpose for the creation of the appraisal remedy would be substantially undercut.

This view of exclusivity can be commended, of course, in terms of efficiency and flexibility on the part of corporations to respond to opportunities for growth and expansion. However, the side effect of the limitation on remedies is that, absent the availability of an appraisal action, shareholders who do not wish to continue their investment in the changed entity are without any remedy. Therefore, in corporations with little or no market for their stock, like cooperatives, denial of appraisal rights creates captive equity.

---

62. *See supra* note 29; *compare* Del. Code Ann. tit. 8, §§ 341-356 (1991).

63. The ability of cooperatives to retain former members' equity for lengthy periods subject to the discretion of the board has been recognized by several decisions. *See supra* note 43.

64. Carney, *supra* note 47, at 96.

65. Armstrong v. Marathon Oil Co., 513 N.E.2d 776, 782 (Ohio 1987); Schloss Assoc. v. Arkwin Indus., Inc., 460 N.E.2d 1090 (N.Y. 1984); *supra* note 45, at § 5906.30. *See also* Revised Model Business Corp. Act § 13.02(b) (1993).

66. James Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right*, 77 Harv. L. Rev. 1189, 1191, 1207-08 (1964); Fishel, *supra* note 60, at 898-901.

III. Appraisal Rights Should be Extended to Cooperative Shareholders

Although cooperatives are recognized as engaging in a variety of transactions making a fundamental change in the cooperative, stockholders in corporate cooperatives have generally been viewed as outside the protection of appraisal statutes.[67] This conclusion has most often been supported by the assertion that cooperatives are different from corporations, thus, cooperative stockholders should not be treated the same as other stockholders.[68] Many cooperatives today, however, have only the dimmest memory of the unique organizing principles cherished by the early leaders in cooperatives.[69] Moreover, even if the organizing principles of cooperatives do distinguish them from general corporations, these differences do not justify denying stockholders appraisal rights.[70] There is no conflict between cooperative principles and appraisal rights. Consequently, dissenters' actions should be available to cooperative shareholders in all states.

A. Distinctions Between Cooperatives and Other Corporate Forms Do Not Support the Denial of Appraisal Rights to Cooperative Shareholders

Some observers and courts have asserted that allowing appraisal rights would curtail mergers among cooperatives by hampering the ability of the successor corporation to survive.[71] This result would supposedly derive from the increased cost of the merger and the reduction in equity capital available to the survivor.[72] As the *Pearson* court argued, "[i]f a minority could insist on being paid in cash, they could wreck the plans for consolidation."[73] This claim is neither derived from any of the operating principles of cooperatives, nor does it distinguish cooperatives from any other corporation.

---

67. Packel, *supra* note 25, at 120-21. The index to the USDA's most extensive treatment of cooperative law does not even contain a reference to dissenting shareholders in cooperatives. *See* Farmer Cooperative Service, *supra* note 18.

68. Sedo, *supra* note 4, at 398-99.

69. *See supra* notes 18-19 and accompanying text.

70. Although concluding that dissenters' rights in agricultural cooperatives are "controversial," a recent observer appears to have reluctantly recognized that unless the provisions of a state's corporate law are somehow "inconsistent" with the cooperative statute (or perhaps principles), appraisal rights for cooperative shareholders would be determined in the same fashion as for stockholders in any other corporation. Matthews, *supra* note 20, at 304-06.

71. Sedo, *supra* note 4, at 397-403. Pearson v. Clam Falls Coop. Dairy Ass'n, 10 N.W.2d 132, 134 (Wis. 1943).

72. This argument is simply the echo of the general response of cooperatives and some economists that any form of judicially required equity redemption program would adversely impact on cooperatives economic viability. *See* Centner, *supra* note 2, at 124-25.

73. *Pearson*, 10 N.W.2d at 134.

The "threat to the corporate enterprise" argument has been raised by critics of dissenters' rights in non-cooperative corporations.

> Even a relatively modest number of shareholders claiming the appraisal remedy may constitute a severe economic threat to the corporate enterprise. . . If [some] shareholders go the appraisal road,. . . a sudden and largely unpredictable drain is imposed upon the corporation's cash position. This demand for a cash pay-out to shareholders often comes at a time when the enterprise is in need of every liquid dollar it can put its hands on.[74]

The merits of this argument have been rejected explicitly by commentators,[75] and implicitly by the drafters of the Revised Model Business Act,[76] the American Law Institute's Principles of Corporate Governance,[77] and the legislatures of all fifty states which have retained the remedy. The costs and capital drain of appraisal claims simply have not been thought onerous enough on corporations to overcome the perception of fairness to the minority.[78]

Many cooperatives today possess financial resources to rival the nation's largest industrial corporations.[79] It is unlikely that they would be any more dissuaded than any other corporation[80] from pursuing a transaction by virtue of the possibility of an appraisal action. Of course, some transactions by cooperatives may not occur in the face of a significant number of dissenting shares. It is not clear, however, why transactions opposed by patrons with enough capital in the cooperative to cause a severe capitalization problem for the new entity should proceed.

This is even more true in cooperatives than other type of corporations. The refusal to allow dissenters' rights is directly contrary to the concept of a cooperative as a voluntary association.[81] Denial of appraisal rights to stockholders in cooperatives transforms a "voluntary" association into an involuntary investment by those who dissent.

Appraisal rights originated, at least in part, to prevent precisely this result:

---

74. Manning, *supra* note 55, at 234.

75. Eisenberg, *supra* note 51, at 70-71.

76. Revised Model Business Corp. Act §§ 13.01-13.31 (1993); Conard, *supra* note 59, at 2592.

77. ALI, Principles of Corp. Governance, *supra* note 45, at §§ 7.21-7.25.

78. Fishel, *supra* note 60, at 881-82. Fishel, while somewhat skeptical of the survival argument in favor of appraisal rights, concludes that either the costs of such actions must be low, or the benefits (value) must be high for the action to have survived. Because an empirical measure of costs is not available, he is unable to conclude what level of benefit was evidenced by the continued legislative approval of the action.

79. *See supra* notes 11-16 and accompanying text.

80. Seligman, *supra* note 1, at 829-30.

81. Centner, *supra* note 2, at 130.

> [I]t is predictable that corporate law would permit a majority, or at least a high majority, to make structural changes even over the objection of minority shareholders. But just as a veto power might be intolerable in a corporation, so might be an unrestricted power in the majority to make structural changes, unless some method was provided whereby minority shareholders would not be locked into the restructured enterprise over their objections. *The minority, in other words, should have the right to say to the majority, "We recognize your right to restructure the enterprise, provided you are willing to buy us out at a fair price if we object, so that we are not forced to participate in an enterprise other than the one contemplated at the outset of our mutual association."* Seen from this perspective, the appraisal right is a mechanism admirably suited to reconcile, in the corporate context, the need to give the majority the right to make drastic changes in the enterprise to meet new conditions as they arise, with the need to protect the minority against being involuntarily dragged along into a drastically restructured enterprise in which it has no confidence.[82]

Although Professor Eisenberg spoke of general corporations, this rationale for dissenters' rights, based on allowing shareholders to withdraw their financial support when the nature of the enterprise changes, is entirely consistent with the traditional principles underlying cooperatives.[83]

The claim that allowing appraisal rights would be contrary to the majoritarian democratic principles of cooperatives[84] simply misses the mark. Appraisal frees the majority to proceed with the fundamental change; it does not limit its ability to act.[85] Moreover, dissenters' rights to withdraw further the notion that cooperatives are voluntary associations of persons working for their mutual benefit. The inability of the cooperative shareholder to transfer his stock without the consent of the cooperative board makes the investment illiquid in the face of fundamental change in the cooperative. Even critics of

---

82. Eisenberg, *supra* note 51, at 78 (emphasis added). This rationale for appraisal rights eliminates any distinction between "membership" shares and other types of stock in the cooperative. *See* discussion *infra* part C.

83. *See supra* notes 18-21 and accompanying text.

84. Sedo, *supra* note 4, at 398-99.

85. Eisenberg, *supra* note 51, at 78; *see also supra* notes 49-53 and accompanying text. For example, a body of case law has developed holding that cooperatives may not enforce bylaw changes adopted by a majority of the board against a minority member. *See, e.g.*, Lambert v. Fishermen's Dock Coop., Inc., 297 A.2d 566, 570-71 (N.J. 1972); Loch v. Paola Farmers' Union Coop., 287 P. 269 (Kan. 1930). The availability of appraisal rights to dissenters, however, should free the majority to proceed with by-law amendments or other structural changes while protecting those who dissent.

appraisal, however, have conceded that this remedy is necessary in circumstances where there is no active market for the stock.[86]

Unless the policy of the state cooperative statutes is to give the majority the power to compel the minority to invest in a cooperative not of its choosing, the criticism of granting appraisal rights to cooperative shareholders collapses. No justification for preferring fundamental corporate change to appraisal rights has been articulated by these commentators and courts.[87] The existence of dissenters' rights provides a significant counterbalance to the majority's wishes and should encourage the board to obtain the best deal for the largest number of shareholders (not just a majority) so as to minimize the cost of potential appraisal proceedings.[88] The result of extending appraisal rights to shareholders in agricultural cooperative should be increased support for the successor cooperative, not the wholesale withdrawal of capital.

Some opponents of appraisal rights for cooperative shareholders have asserted that the issue is essentially the same as when cooperatives are confronted with a demand for redemption of equity outside of the appraisal context.[89] Many cooperatives simply retain the equity with no program for redeeming these securities.[90] Because of the restrictions on transfer of cooperative's stock, the holders of these equities are unable to recover their investment through market transactions. Absent statutory mandates, courts have refused to force cooperatives to buy back patrons' stock.[91]

The charters of most cooperatives provide that the redemption of outstanding equity held by patrons is within the discretion of the board of directors.[92] Although several systems for retiring these equities have been

---

86. Moscow, *supra* note 54, at 1027.

87. In the case of a former member seeking redemption from an ongoing cooperative, one court did conclude that "[t]he paramount concern is the continuation of the cooperative." Sanchez v. Grain Growers Ass'n of California, 179 Cal. Rptr. 459, 460 (1981). Whatever may be the merits of this policy choice in the case of an ongoing cooperative (*See* Centner, *supra* note 2, at 142-43), the decision is inapplicable to cases involving fundamental changes to the corporation that trigger appraisal. By definition the dissenting stockholder did not choose to become member, patron or investor in the transformed cooperative.

88. Eisenberg, *supra* note 51, at 83-84.

89. Sedo, *supra* note 4, at 399 n.126. The analogy to equity redemption cases actually supports the cooperative shareholder's right to appraisal in one regard: appraisal and payment of the value of the patrons equity position does not violate the cooperative principle of returns based on use. This issue in the redemption cases is not whether appraisal and payment are proper within the cooperative concept, but rather whether the cooperative can be judicially compelled to repurchase the stock when its charter makes this act discretionary with the board.

90. Centner, *supra* note 2, at 123 n.20.

91. Christian County Farmers Supply Co. v. Rivard, 476 N.E.2d 452 (Ill. Ct. App. 1985). This issue has repeatedly been litigated within the bankruptcy context. Holders of cooperative equities have frequently responded to claims for debts owed to cooperatives by attempting to set off the amount of securities owned against the claim. Courts, however, have consistently refused to allow the set off. Hamilton, *supra* note 19, at 610-17.

92. Centner, *supra* note 10, at 345-47.

proposed, these systems generally reserve the ultimate timing of redemption to the board in the bylaws or articles. Relying on a contractual understanding of their charter, then, cooperatives have successfully resisted most efforts to compel redemption.[93]

In deciding these cases, courts have examined the impact of contractual relationship between the continuing cooperative and its members on the nature of the equities held by patrons.[94] In all of these cases, it was the equity owners' relationship with the cooperative that had changed. Appraisal rights, however, are given to shareholders only on events which work a fundamental change in the corporation.[95] By definition, then, appraisal rights would only be available when the cooperative has changed in a way that impacts on its charter contract with its investors. The contractual analysis of the equity redemption cases leads to the conclusion that appraisal rights should be available to cooperative dissenters. Historically, the contractual view of corporate charters formed the basis for the creation of appraisal rights.[96] Moreover, the events triggering the right to appraisal are derived from statute. They cannot contractually be made contingent on the discretion of the board of directors.[97] Regardless of the decisions on equity redemption by former or bankrupt members of continuing cooperatives, cooperative stockholders should be given the same dissenters' rights as other corporate shareholders have upon fundamental changes in the corporation.

B. The Non-Profit Charaterization of Cooperatives is an Invalid Basis for Denying Appraisal Rights to Cooperative Shareholders

One early observer of agricultural cooperatives concluded that "[t]he profit incentive is the mainspring of commerce, but it is the antithesis of cooperation."[98] Some states have gone so far as to statutorily designate cooperatives

---

93. *Id.* at 344. In those rare instances when the charter can be read as limiting the director's discretion, the courts have sometimes found for the "preferred stock" shareholder. *See* Collie v. Little River Coop., Inc., 370 S.W.2d 62 (Ark. 1963).

94. *See* Universal Coop., Inc. v. FCX, Inc., 853 F.2d 1149, 1154 n.5 (4th Cir. 1988), *cert. denied*, 489 U.S. 1011 (1989); Atchison County Farmers Union Coop. Ass'n v. Turnbull, 736 P.2d 917, 921 (Kan. 1987); Weise v. Land O'Lakes Creameries, Inc., 191 N.W.2d 619, 622 (Iowa 1971) (return of equity credits upon cooperative merger is discretionary with the board).

95. *See supra* note 45 and accompanying text.

96. *See supra* notes 47-48 and accompanying text.

97. *Compare* Waters v. Double L, Inc., 755 P.2d 1294, 1303 (Idaho Ct. App. 1989), *aff'd.*, 769 P.2d 582 (Idaho 1989) (stating that corporation's compliance with a contractual stock repurchase agreement does not prevent shareholder appraisal claims). There does not appear to be any state which allows parties to contract away their appraisal claims in advance. *See* Fishel, *supra* note 60, at 881 n.22.

98. Gerard C. Henderson, *Cooperative Marketing Associations*, 23 Colum. L. Rev. 91, 111

as "non-profit."[99] A few states have gone even further and incorporated the provisions of their non-profit corporation law into the cooperative statute.[100] This designation is a statutory attempt to recognize the traditional notion that cooperatives return any earnings to their patrons.[101] While the principle of returning earnings to patrons is not inconsistent with appraisal rights for dissenting shareholders, legislative efforts to describe this principle by designating cooperatives as non-profit have created additional confusion regarding shareholders rights. In fact, state classification of cooperatives as non-profit has sometimes been relied upon to deny appraisal rights to cooperative stockholders.[102]

Even if designated as non-profit, cooperatives are economic institutions operated to generate a profit.[103] Cooperative corporations are not eleemosynary; rather they are designed to make money for their patrons.[104] Not only do cooperatives strive to generate profits for their members but, perhaps more importantly for purposes of dissenters' rights, they "[differ] from other [non-profit corporations] in that members . . . have investments in the organization."[105]

The original cooperative concept simply required that the entity's earnings be passed through to the patrons. Today's elaborate system of equity retains, however, has altered the traditional concept of the "profits" being returned to

---

(1923).

99. *See, e.g.*, Kan. Stat. Ann. §§ 17-1602 (1988). One authority concludes that, absent specific statutes, cooperatives can incorporate under the provisions of a state's non-profit corporation law. PACKEL, *supra* note 25, at 57-58.

100. Ohio Rev. Code Ann. § 1729.27 (Anderson, 1992). Other states incorporate corporation codes that include provisions applicable to both non-profit corporations and profit corporations. *See, e.g.*, KAN. STAT. ANN. §§ 17-1628 (1988).

101. Farmer Cooperative Service, *supra* note 18, at 221 n.9.

102. Denes v. Countrymark, Inc., 580 N.E.2d 1135, 1139-40 (Ohio Ct. App. 1989).

103. Kohls & Uhl, *supra* note 20 at 226-27; First Wisconsin Nat'l Bank of Milwaukee v. Wisconsin Coop. Milk Pool, 119 F.2d 999, 1002 (7th Cir. 1941), *cert. denied*, 314 U.S. 655 (1941) (Cooperatives' "sole motive is pecuniary gain."). This motive was even recognized by the early judicial apologists for cooperatives. *See* Frost v. Corporation Comm'n of Oklahoma, 278 U.S. 515, 537 (1929) (Brandeis, J., dissenting).

104. Although some commentators prefer to characterize the earnings of cooperatives as "excess revenue" (*see* Sedo, *supra* note 4, at 379) instead of profit, cooperatives have consistently been held not to be traditional non-profit corporations. Schuster v. Ohio Farmers' Coop. Milk Ass'n, 61 F.2d 337 (6th Cir. 1932); Diekmann v. Evansville Producers Comm'n Ass'n, 40 N.E.2d 327, 329 (Ind. 1942); Missco Homestead Ass'n v. United States, 185 F.2d 280 (8th Cir. 1950). *See also* Note, *Involuntary Bankruptcy—Cooperative Marketing Associations*, 19 Hastings L.J. 362, 363-64 (1968). *Cf.* Burley Tobacco Growers' Coop. Ass'n v. Rogers, 150 N.E. 384, 386 (Ind. Ct. App. 1926); and Mutual Orange Distrib. v. Black, 287 S.W. 846 (Mo. Ct. App. 1926) (holding that cooperatives were not subject to license requirements for foreign corporations because of their non-profit nature).

105. Marilyn E. Phelan, Nonprofit Enterprises: Law & Taxation § 20.01, at 2 (1989) (footnote omitted).

the producers. Although the system allows these earnings to be taxed at the patron level,[106] the receipt of these funds is frequently deferred for extended periods of time.[107] These equity accounts reflect ownership interests of the cooperatives' patrons,[108] a concept totally foreign to typical non-profit corporations.

Most state statutes also allow cooperatives to sell stock to investors regardless of their member or patron status. These stocks generally pay a specified dividend and have certain liquidation preferences. Some cooperatives are also allowing management to participate in "profits" by adopting stock incentive plans designed to give a portion of the increased value of the cooperative to management.[109] In short, cooperatives may have a variety of non-member owners with substantial ownership and investment interests. Such a capital structure would be unheard of in conventional non-profit corporations.[110]

The statutory designation of cooperatives as non-profit corporations causes confusion regarding appraisal rights in cooperatives in at least two ways. Modern non-profit corporations can merge and engage in a variety of transactions which would trigger appraisal rights in business corporations. Because members of typical non-profit corporations generally "have no economic interest in their corporation," they have no right to appraisal of their shares upon a merger of their corporation.[111] Stockholders of cooperatives, in contrast, have investments in the cooperative. Thus, the rationale for denying appraisal rights in the non-profit context is not available to cooperatives. Rather, the general corporation laws' protection of minority investors from compulsory capital contributions to the changed enterprise[112] should prevail and allow dissenting cooperative owners appraisal.

Additionally, many state statutes limit voting in non-profit corporations to members. Because appraisal rights are frequently tied to voting rights,[113] the use of the non-profit statutes would limit the ability of non-member stockholders to obtain appraisal of their cooperative shares. State law generally requires

---

106. I.R.C. § 1385 (1992).

107. Centner, *supra* note 26, at 255.

108. Nieman, *supra* note 39, at 139-48.

109. Fleck, *supra* note 13, at 87-88.

110. Elaborate equity investment by patrons and substantial investment by non-patrons or management cause efforts to distinguish "entrepreneurial profit" from cooperative earnings to fail. Packel, *supra* note 25, at 6-7. The use of management stock incentive plans is entirely entrepreneurial. Many successful cooperatives' stock have book values substantially in excess of par. FARMER COOPERATIVE SERVICE, *supra* note 18, at 31.

111. Rev. Mod. Non-Profit Corp. Act § 11.01 Official Comment (1988).

112. *See supra* note 51.

113. Del. Code Ann. tit. 8, § 262(a) (1991); REV. MOD. BUS. CORP. ACT § 13.02 (Supp. 1991).

only the vote of the members of a nonprofit corporation to effect a merger. This limitation is not the result of a legislative determination that the nonmember shareholders of a nonprofit corporation should not be allowed to vote, but rather is because nonprofit corporations do not have non-member shareholders in the first place. There are simply no non-member investors whose interests require the protection of voting rights in the merger of a traditional nonprofit corporation.

The issue, then, is not whether cooperatives are deemed to be nonprofit, but whether cooperatives should be treated as nonprofit corporations for the specific purpose of appraisal rights. This issue can only be resolved by an analysis of the reasons the appraisal provisions of general corporate statutes and non-profit statutes differ, as well as an analysis of the capital structure of the two types of corporations. Because cooperatives more closely resemble commercial corporations in their capital and investment structure, the provisions of a state's general corporation codes should govern on the question of appraisal.

C. Appraisal Rights Should Not be Limited to Shareholders with Voting Shares

Although the American Law Institute has concluded that shareholder voting and the appraisal remedy should not be linked,[114] dissenters' rights statutes generally require that the shareholder seeking appraisal has voted his shares against the transaction.[115] The capital structure of most cooperatives, however, includes a vast array of equity investments,[116] but only a limited number of voting shares. Limiting the availability of appraisal to voting membership shares would make the remedy relatively meaningless in the context of cooperatives.[117] Not only would members be limited in their claims, but holders of non-voting patronage or preferred stock, along with the owners of equities not constituting stock, would be entirely excluded from the appraisal action.

---

114. A.L.I., Principles of Corporate Governance, *supra* note 45, at 945. Unless a court is willing to impose appraisal as a remedy in situations beyond those enumerated by statute, *see supra* note 50, only those shareholders entitled to vote on the corporate transaction at issue will generally be entitled to appraisal. Because of the capital structure of most cooperatives (*see supra* notes 29-38 and accompanying text), this may limit the amount of equity investment which may be appraised.

115. Del. Code Ann. tit. 8, § 262(a) (1991); REV. MOD. BUS. CORP. ACT § 13.02 (Supp. 1991).

116. Centner, *supra* note 2, at 136-38.

117. Although some courts have allowed appraisal for membership shares, because these shares represent only a minuscule amount of the equity in a cooperative, the efficacy of this remedy is extremely limited. In fact, the Eighth Circuit recently noted that membership shares are relatively worthless. Farmers Coop. Co. v. Commissioner of Internal Revenue, 822 F.2d 774, 779 n.6 (8th Cir. 1987).

Recognizing the variety of equity instruments that exist in cooperatives, the states that have adopted statutes providing for appraisal of cooperative investments have generally included all types of equity owned by the dissenter.[118] At least one of these states extends this protection only to members,[119] while others require only that the dissenter be a shareholder.[120] Neither of these approaches provides any relief for the non-member patron whose equity position contains no stock.[121]

Absent legislation, courts have not allowed non-voting equity interests to be appraised.[122] In reaching this conclusion, the courts have ignored the provisions of state corporate law that provide for voting rights upon issues of fundamental change. Within the context of fundamental corporate change, the right to vote encompasses more than just the holders of voting common stock. Generally, all stockholders, including owners of non-voting common and preferred stock, are permitted to vote on fundamental changes which affect their position with the corporation.[123] Thus, the body of shareholders entitled to seek appraisal frequently includes the owners of non-voting stock.

Corporate law has long distinguished between the more routine decisions affecting the operation of a corporation and fundamental changes that reach the very nature of the organization in which the shareholder owns an equity interest.[124] This distinction has been recognized in cooperative corporations as well. Some fundamental changes or matters which are generally voted upon by the members are the number of shares or number of members of the cooperative, incurrence of long-term indebtedness, and decisions to end the cooperative reorganization, merger and consolidation.[125]

Democratic control of the cooperative by its members, however, has been viewed as one of the traditional concepts that separates corporate cooperatives

---

118. These statutes are not limited to determining the value of the dissenter's stock. Rather, they provide for the determination of "the net value of [the stockholder's or member's] equity" (Mont. Code Ann. § 35-16-211 (1991)) or for the value of shareholders "property interest" (VT. STAT. ANN. tit. 11, § 1061(2) (1984). Although these terms are not defined, they presumably encompass more than stock. Van Der Maaten v. Farmers Coop. Co., 472 N.W.2d 283 (Iowa 1991).

119. Vt. Stat. Ann. tit. 11, § 1061(2) (1984).

120. Mont. Code Ann. § 35-16-211 (1991); UTAH CODE ANN. § 3-1-39 (1988).

121. Of course, the approach advocated here (i.e. applying existing corporation law to agricultural cooperatives) would not protect these owners in any state whose appraisal statute was specifically limited to "shares" or "stock." To provide for these individuals, legislative action would be necessary.

122. Denes v. Countrymark, Inc., 580 N.E.2d 1135, 1141 (Ohio Ct. App. 1989).

123. Shidler v. All Am. Life & Fin. Corp., 298 N.W.2d 318 (Iowa 1980); Rev. Model Bus. Corp. Act § 13.02 Official Comment (Supp. 1991).

124. *See generally* William A. Klein & John C. Coffee, Jr. Business Organization & Finance 206-07 (Foundation Press 1993).

125. Packel, *supra* note 25, at 118-21.

from other types of corporations.[126] To the extent that state law requires the dissenters' shares to have been voted against the transaction, the requirement of "member" control might be viewed as the reason for denying holders of stock (other than voting member common stock) appraisal rights. This dilemma takes on added importance because member control has been thought to be crucial to an entity's ability to claim many of the statutory advantages of cooperatives. If non-members cannot vote their cooperative stock without eliminating the cooperative status of the entity, extending appraisal rights to holders of non-membership stock would be highly problematic.

Member control of the cooperative is a factor in determining whether a cooperative will be exempt from the antitrust laws under the Capper-Volstead Act,[127] whether a cooperative is eligible to borrow from federally-chartered cooperative banks under the Farm Credit Act,[128] and whether the cooperative will qualify under the Agricultural Marketing Act.[129] In addition, it determines whether the cooperative will be eligible for special treatment as a tax-exempt organization under § 521 of the Internal Revenue Code[130] or whether it will qualify under Subchapter T of the Internal Revenue Code.[131] However, each of these statutes contemplates that the cooperative will have "non-member", "non-patron" voting shareholders, as well as members who own non-voting stock.[132]

For example, the Capper-Volstead Act extended an antitrust exemption to cooperatives organized with capital stock:

> Only non-stock organizations were exempt under the Clayton Act, but various agricultural groups had discovered that, in order best to serve the needs of their members, accumulation of capital was required. With capital, cooperative associations could develop and provide the handling and processing services that were needed before their members' products could be sold. The Capper-Volstead Act was passed to make it clear that the formation of an agricultural organization with capital would not result in a violation of the antitrust laws, and that the organization, without antitrust consequences, could perform certain functions in preparing produce for market.[133]

---

126. Kohls and Uhl, *supra* note 20, at 208-09.
127. 7 U.S.C. §§ 291-292 (1988).
128. 12 U.S.C. §§ 2121-2149 (1988).
129. 12 U.S.C. §§ 1141-1141j (1988).
130. 26 U.S.C. § 521(b)(2) (1988).
131. 26 U.S.C. §§ 1381-1388 (1988).
132. *See, e.g.*, West Central Coop. v. United States, 758 F.2d 1269 (8th Cir. 1985), *cert. denied*, 474 U.S. 1000 (1985). *See also* Nieman, *supra* note 39, at 139-48.
133. National Broiler Mktg. Ass'n v. United States, 436 U.S. 816, 824-25 (1978).

Thus, a principal reason for the Capper-Volstead Act was to permit cooperatives to raise funds in the capital markets from non-members.[134] Moreover, all of these federal statutes recognize a right for investors, whether they are members or non-members, to receive a return on their investment in the form of dividends.[135]

Allowance of appraisal rights to all shareholders would not jeopardize the corporations favorable tax and antitrust treatment.[136] For example, the recent antitrust decisions[137] focused only on non-producers roles as "members" of the cooperative. In no way did these cases limit the right of non-member (or non-voting) shareholders to vote on extraordinary transactions effecting fundamental change in the life of the cooperative.[138] At most, the Court has given tacit recognition for this right by limiting the prohibition for "control and policy making."

Recognition of the general corporate law provisions regarding voting on fundamental change in the cooperative would not be inconsistent with the concept of member control. These questions go far beyond "policy"; they reach the very substance of the entity itself. Moreover, the incorporation of the general corporation law provisions regarding voting on organic changes by otherwise non-voting stock would not be inconsistent with cooperative statutes. The transactions would simply need to be approved by the board and members as set out in the cooperative statute, plus any other stockholders that are entitled to vote under the general corporate law.

---

134. 60 Cong. Rec. 365 (1920) (statements of Senator Walsh); 62 CONG. REC. 2271 (1922) (statements of Senator Walsh); 62 CONG. REC. 2273 (1922) (statements of Senator Norris).

135. 26 U.S.C. § 521(b)(2) (1988); 12 U.S.C. § 1141j(a) (1988); 12 U.S.C. § 2129(a)(2) (1988).

136. Indeed, far from jeopardizing a cooperative's antitrust protection, allowance of appraisal rights may help insulate a merger of cooperative from antitrust scrutiny. *See* Donald F. Turner, Address to the National Conference of Fruit and Vegetable Bargaining Cooperatives (1966), *in* HARL, 14 AGRICULTURAL LAW § 137.06[9] n.197 (1992). For a recent summary of the status of agricultural cooperatives tax and antitrust exceptions, see Matthews, *supra* note 20, at 288-96.

137. *See, e.g.*, Case-Swayne Co., Inc. v. Sunkist Growers, Inc., 389 U.S. 384, 394-96 (1967), *reh'g denied*, 390 U.S. 930 (1968).

138. At least two states require approval of two-thirds of the preferred shares in the cooperative voting as a class before any change can be made in the preferences granted the stock. *See* Haw. Rev. Stat. § 421-11(e) (1985) and ME. REV. STAT. ANN. tit. 13, § 1912(5) (West, 1981). These provisions are derived from the former Uniform Agricultural Cooperative Act. *See supra note 22*. Other states require holders of the affected stock to approve any changes in a class vote, but limit shareholders to one vote regardless of the number or value of shares owned. WIS. STAT. ANN. §§ 185.52, 185.61(3) (West 1992).

V. CONCLUSION

Regardless of whether cooperatives are viewed as unique entities representing groups of producers working together or simply an agri-business variation on large industrial corporations, dissenting cooperative shareholders should be entitled to the same protection afforded shareholders in other corporations. Appraisal rights are consistent with the traditional operating principles underlying cooperatives; they further the goals of democratic control and voluntary association. The policies sought to be achieved by appraisal rights would also be furthered by applying these statutes to cooperatives.

Only a few states have expressly adopted legislation giving this right of action to cooperative shareholders. Even these statutes, generally limited to members, are inadequate to protect the wide array of equity investments in cooperatives made by patrons and investors. Incorporation of the appraisal provisions of states' general corporations laws, while reaching any shareholder, also misses the valuation of various forms of cooperative equity not represented by stock. Thus, even though appraisal should be judicially recognized under current law in any circumstance in which it is available to shareholders of other corporations, legislative action is required to make the remedy fully efficacious for cooperative owners whether they be members, patrons or owners.

Abandoning Parents Under Intestacy: Where We Are, Where We Need to Go

Anne-Marie E. Rhodes*

Introduction

American children are increasingly being raised in single parent homes, often below or near the poverty line. One consequence is that the issues of child welfare and child support receive significant media and legal attention, and beneficial changes in the legal landscape have occurred.[1] Away from the highly visible and immediate problems of child welfare and child support are less celebrated legal issues, that often graphically underscore the systemic nature of the law's difficulty in dealing with questions of parental irresponsibility. One such example involves the overlay of a parent who has abandoned a child, with the disposition of property at that child's death. Two fact patterns set the stage for discussion.

First, an infant boy contracts meningitis, is misdiagnosed and improperly treated, and consequently suffers permanent severe brain damage. The mother and father jointly care for their son for two years; the father later voluntarily abandons the mother and son. The father starts a new life and family far away from his former wife and son. The mother continues to care for her son for eighteen years without any assistance or contact from the father. After years of litigation, money is finally awarded to the young man for his injuries. Thereafter the son dies.

The second scenario concerns a fifteen-year-old teenage boy killed in a car accident. The child's estate pursues a wrongful death action and obtains a money settlement. The young boy's parents were divorced when he was two. His mother voluntarily moved far away and started a new life. The son had not seen or heard from his mother in any of the thirteen years following the divorce. The father has raised his son for thirteen years without any assistance from the mother.[2]

---

* Professor of Law, Loyola University of Chicago School of Law. This research was funded in part by grants from Loyola University Research Stimulation fund and its law school's summer research fund. I acknowledge and thank James Curtin for his editorial comments, and David W. Hepplewhite for his comments and encouragement.

1. *See, e.g.*, Family Support Act, 42 U.S.C. § 666(a)(5)(B) (1988). *See also* Paula Roberts, *Child Support Enforcement: An Introduction*, 25 Clearinghouse Rev. 868 (1991); America's Children at Risk: A National Agenda for Legal Action (A.B.A. 1993).

2. *See* Hotarek v. Benson, 557 A.2d 1259 (Conn. 1989); discussed in M. Katherine Glassman & Marie T. Falsey, *Connecticut Probate Law 1989*, 64 Conn. B.J. 43, 55-56 (1990). The first scenario is hypothetical.

In both of these scenarios, there is property to be distributed because of the child's death. In both cases, the decedent was without legal capacity to execute a will or any other effective expression of testamentary disposition. Lacking valid instruction from the decedent, the distribution of the property may be governed by the jurisdiction's intestate rules.

In the first hypothetical involving the decedent's own property, distribution of his estate is a direct application of the jurisdiction's intestate rules. That is, after all, what it means to die without a will. In the second hypothetical involving wrongful death, the distribution of the award will depend on that particular jurisdiction's wrongful death laws. Some jurisdictions provide for distribution to or paralleling the decedent's estate, and thus the intestate rules will again govern. Other jurisdictions provide for distribution based on a standard of dependency or according to the personal loss sustained.

In the vast majority of jurisdictions the intestate rules treat an abandoning parent as an equal heir with the non-abandoning parent. Equity requires a different result. Moreover in those jurisdictions where the wrongful death statute applies a dependency standard for distribution, the abandoning parent generally does not share equally in the distribution of wrongful death proceeds, even though that parent would share equally in an intestate distribution. Consistency, as well as equity, requires that an abandoning parent in either scenario not participate in the property distribution.

This Article will first review the statutory rules governing the distribution of property of an intestate decedent and the distribution of proceeds under wrongful death statutes. Three solutions to the inequity of an abandoning parent as legal heir will be presented. The first solution is a matter of statutory interpretation of parent as heir. The second considers a common law theory that has ancient Roman law origins. The third involves the application of existing statutes.

I. STATUTORY RULES GOVERNING DISTRIBUTION

The situation of a parent who willfully abandons the duties and obligations owed to a child arises principally during the child's minority since parental legal duties generally cease when a child reaches majority.[3] Thus, the abandonment is at a time when the child lacks legal capacity to execute a will.[4] Distribution of a minor child's property (for example, the proceeds of

---

3. Some jurisdictions may impose continuing obligations upon parents if an adult child is disabled. *See* JEFF ATKINSON, MODERN CHILD CUSTODY PRACTICE, § 10.18 (1986 & Supp. 1992) Also, parents in a divorce context may be obligated by decree for ongoing obligations of child support, usually related to college education and medical expenses. Jeff Atkinson, *Support for a Child's Post-Majority Education*, 22 LOY. U. CHI. L.J. 695 (1991).

4. Virtually all American jurisdictions impose an age requirement for the execution of a will. THOMAS E. ATKINSON, LAW OF WILLS 230 (2d. ed. 1953). Many jurisdictions require a testator to be at least eighteen, although the age varies. *See* WILLIAM J. BOWE & DOUGLAS H.

a personal injury lawsuit) will be governed by the intestate rules. Similarly, if the child reaches majority but lacks the requisite mental capacity to execute a will, the intestate rules will govern.[5]

In a wrongful death action, the decedent generally does not own the property that is to be distributed by reason of his death, so the intestate rules do not apply. Instead, distribution of the proceeds is governed by the jurisdiction's wrongful death statute. Generally those statutes follow one of two dispositive patterns: (1) a distribution based on a fact-specific standard of dependency, or (2) a distribution to or parallel to that of the decedent's estate (be it testate or intestate).

The source of the property is therefore the distinguishing feature: the child's own property will be distributed pursuant to the jurisdiction's intestate laws, whereas property statutorily created by virtue of the child's wrongful death will be distributed according to the wrongful death statute.

A. Rules of Descent and Distribution

All states provide rules governing the transfer at death of a decedent's property.[6] When a decedent as in our hypotheticals cannot leave a will, the state's intestate statute will provide the rules for distributing the decedent's property. In both hypotheticals, the decedent is unmarried, with no descendants, and with a surviving mother and father. There may or may not be a sibling of the whole blood, and there is a sibling of the half blood.

Applying this fact pattern to the various intestate rules throughout the United States reveals that in the vast majority of states the decedent's surviving parents would receive the entire estate equally under those intestate rules, without regard to abandonment.[7] In several jurisdictions, brothers and

---

PARKER, PAGE ON WILLS § 12.8 (rev. ed. 1959). In Georgia, for example, the age is fourteen. GA. CODE ANN. § 53-2-22 (1982).

5. *See* SAMUEL J. BRAKEL ET AL., THE MENTALLY DISABLED AND THE LAW 435-41 (3d ed. 1985) for an illuminating discussion of the application of the "sound mind" standard for testamentary capacity.

6. For a summary listing of such sources, *see* Jeffrey A. Schoenblum, PAGE ON THE LAW OF WILLS, APPENDIX (1991).

7. *See, e.g.*, ALA. CODE § 43-8-42 (1991); ALASKA STAT. § 13.11.015 (1985); ARIZ. REV. STAT. ANN. § 14-2103(A) (Supp. 1992); ARK. CODE ANN. § 28-9-214 (Michie 1987); CAL. PROB. CODE § 6402 (West 1991); COLO. REV. STAT. ANN. § 15-11-103 (West 1989); CONN. GEN. STAT. ANN. § 45a-439 (West Supp. 1993); DEL. CODE ANN. tit. 12, § 503 (1987); FLA. STAT. ANN. § 732.103 (West Supp. 1993); HAW. REV. STAT. § 532-4 (1993); IDAHO CODE § 15-2-103 (1979); IOWA CODE ANN. § 633.219 (West 1992); KAN. STAT. ANN. § 59-507 (1983); KY. REV. STAT. ANN. § 391.010 (Michie/Bobbs-Merrill 1984); ME. REV. STAT. ANN. tit. 18-A, § 2-103 (West 1981); MD. CODE ANN., EST. & TRUSTS § 3-104 (1991); MASS. GEN. L. ch. 190, § 3 (1981); MICH. COMP. LAWS ANN. § 700.106 (West 1980); MINN. STAT. ANN. § 524.2-103 (West Supp. 1993); MONT. CODE ANN. § 72-2-113 (Supp. 1993); NEB. REV. STAT. § 30-2303 (1989); NEV. REV. STAT. § 134.050 (1981); N.H. REV. STAT. ANN. § 561:1 (1974); N.J. STAT. ANN. § 3B:5-4 (West 1983); N.M. STAT. ANN. § 45-2-103 (Michie 1989); N.Y. EST. POWERS & TRUSTS LAW §

sisters share with the parents on a per capita basis,[8] with most of those jurisdictions treating siblings of the half-blood the same as siblings of the whole blood.[9] Louisiana gives the parents a usufruct and the brothers and sisters the ownership subject to the usufruct.[10] Only a handful of jurisdictions statutorily exclude abandoning parents from inheriting,[11] while the majority of intestate rules are silent as to the effect of abandonment.

A guiding principle in fashioning intestate rules is that those rules should reflect the normal desires of an owner of wealth as to the disposition of property at death.[12] It seems obvious that an owner of wealth would prefer a known caring parent to an unknown abandoning parent. In our hypotheticals, the intestate rules often fail this objective.

4-1.1 (McKinney 1981); N.C. GEN. STAT. § 29-15 (1984); N.D. CENT. CODE § 30.1-04-03 (1976); OHIO REV. CODE ANN. § 2105.06 (Anderson 1990); OKLA. STAT. ANN. tit. 84, § 213 (West 1990); OR. REV. STAT. § 112.045 (1990); 20 PA. CONS. STAT. ANN. § 2103 (1993); R.I. GEN. LAWS § 33-1-1 (1984); S.C. CODE ANN. § 62-2-103 (Law. Co-op. 1987 & Supp. 1992); S.D. CODIFIED LAWS ANN. § 29-1-6 (1984); TENN. CODE ANN. § 31-2-104 (1984); TEX. PROB. CODE ANN. § 38 (West 1980); UTAH CODE ANN. § 75-2-103 (1993); VT. STAT. ANN. tit. 14, § 551 (1989); VA. CODE ANN. § 64.1-1 (Michie 1991); WASH. REV. CODE ANN. § 11.04.015 (West 1987); W. VA. CODE § 42-1-3(a) (Supp. 1992); WIS. STAT. ANN. § 852.01 (West 1971 & Supp. 1992).

8. GA. CODE ANN. § 53-4-2 (Supp. 1992); 755 ILL. COMP. STATS. § 5/2-1 (1993); IND. CODE § 29-1-2-1 (Supp. 1992) (but a surviving parent's share shall not be less than one-quarter of the estate); MISS. CODE ANN. § 91-1-3 (1972); MO. REV. STAT. § 474.010 (1992); WYO. STAT. § 2-4-101 (1992).

9. GA. CODE ANN. § 53-4-2 (Supp. 1992); 755 ILL. COMP STATS. § 5/2-1 (1993); IND. CODE § 29-1-2-5 (1979); and WYO. STAT. §2-4-104 (1980). Both Mississippi and Missouri seem to exclude half-blood collaterals from inheriting, except if there are only half-blood collaterals. MISS. CODE ANN. § 91-1-5 (1972); MO. REV. STAT. § 474.040 (1992).

10. LA. CIV. CODE ANN. art. 891 (West Supp. 1993).

11. *E.g.*, N.C. GEN. STAT. § 31A-2 (1984); N.Y. EST. POWERS & TRUSTS LAW § 4-1.4 (McKinney 1981); 20 PA. CONS. STAT. ANN. § 2106(b) (Supp. 1993); CONN. GEN. STAT. ANN. § 45a-439 (West Supp. 1993); VA. CODE ANN. § 64.1-16.3 (Michie Supp. 1993); OHIO REV. CODE ANN. § 2105.10 (Anderson Supp. 1992). *See infra* notes 67-95 and accompanying text.

12. Allison Dunham, *The Method, Process and Frequency of Wealth Transmission at Death*, 30 U. CHI. L. REV. 241 (1963): "The laws of intestate succession are frequently asserted to be governed by the principle 'that when a man dies without a will the law should try to provide so far as possible for the distribution of his estate in the manner he would most likely have given effect to himself if he had made a will.'" Uniform Probate Code 36 (7th ed. 1987): "The Code attempts to reflect the normal desire of the owner of wealth as to disposition of his property at death. . . ." *See also* Mary Louise Fellows, *et. al.*, *Public Attitudes About Property Distribution at Death and Intestate Succession Laws in the United States*, 1978 AM. B. FOUND. RES. J. 319 (1978); and Martin L. Fried, *The Uniform Probate Code: Intestate Succession and Related Matters*, 55 ALB. L. REV. 927 (1992). *But see* Mark L. Ascher, *The 1990 Probate Code: Older and Better or More Like the Internal Revenue Code?*, 77 MINN. L. REV. 639 (1993).

B. Wrongful Death Distribution

Under English common law there was no civil action for wrongful death.[13] In 1846, the English parliament first authorized a civil cause of action for wrongful death—the Fatal Injuries Act, more commonly known as Lord Campbell's Act.[14] It allowed "families of persons killed by accidents" to recover for damages "proportioned to the injury resulting from such death."[15] Today all fifty states have adopted some form of wrongful death statute, with some having multiple forms of recovery.[16]

In the second hypothetical involving the fatal car accident, the decedent is an unmarried minor, with no descendants, and with a surviving mother and father. Applying these facts to the various wrongful death statutes reveals that the majority of jurisdictions distribute the wrongful death proceeds on a fact specific basis of subjective relationship and dependency.[17] Recovery

---

13. The reference most often cited is Baker v. Bolton, 1 Campb. 493, 170 Eng. Rep. 1033 (K.B. 1808): "In a civil Court the death of a human being could not be complained of as an injury; and in this case the damages, as to the plaintiff's wife, must stop with the period of her existence." The most traditional rationale is the felony-merger doctrine. *E.g.*, Higgins v. Butcher, 1 Brownl. & Golds 205, Yelv. 89, 80 Eng. Rep. 61 (K.B. 1607): "[I]f a man beats the servant [of another] so that he dies of that battery, the master shall not have an action against the other for battery and loss of the service, because the servant dying of the extremity of the battery, it is now become an offence to the Crown, being converted into felony, and that drowns the particular offence and private wrong offerd to the master before, and his action is thereby lost. . . ." *But see* Wex S. Malone, *The Genesis of Wrongful Death*, 17 STAN. L. REV. 1043 (1965); Mary C. Sweeney, *Right of Surviving Spouse to Damages for Loss of Consortium*, 26 TRIAL LAW. GUIDE 221 (1982-83). *See also* Anne E. Seman, Note, *Pecuniary Injuries Under the Illinois Wrongful Death Act: Is the Loss of a Child's Society Included?*, 15 LOY. U. CHI. L.J. 595 (1984); Adrienne Lehrbaum-Weiss, Case Comment, *Bullard v. Barnes—Parental Recovery for Lost Society and Companionship of a Minor Child Under the Illinois Wrongful Death Act*, 34 DEPAUL L. REV. 803 (1985).

14. Officially entitled "An Act compensating the Families of persons Killed by Accidents," (Fatal Injuries Act) 1846, 9 & 10 Vict., ch. 93 (Eng.).

15. *Id.*

16. STUART M. SPEISER ET AL., RECOVERY FOR WRONGFUL DEATH § 1:13 (3d ed. 1992). There are two basic types of state statutes providing for recovery in wrongful death situations. The more common pattern is a death act, based on Lord Campbell's Act, which provides a new direct cause of action on behalf of designated persons to recover for the decedent's wrongful death, with damages generally measured by the loss to the survivors. The less common pattern is a survival act, with a cause of action lodged in the decedent's executor or administrator, with damages measured by injuries suffered by the decedent, which may include the loss of the decedent's ability to carry on life's activities. Some jurisdictions have both, as well as special legislation. *Id.* at § 1:14.

17. *See* ARIZ. REV. STAT. ANN. § 12-612 (1992) ("in proportion to their damages"); ARK. CODE ANN. § 16-62-102 ("shall fix the share of each beneficiary"); CAL. CIV. PROC. CODE §§ 376 and 377.61 (West 1973 & Supp. 1993) ("shall determine the respective rights in an award"); DEL. CODE ANN. tit 10, § 3724 (Supp. 1992) ("to the beneficiaries proportioned to the injury"); HAW. REV. STAT. § 663-3 (1988) ("shall allocate the damages to the persons entitled thereto"); IDAHO CODE § 5-310 (1990); 740 ILL. COMP. STAT. § 180/2 (1993) ("to each of . . . the next of kin . . . in the proportion . . . that the percentage of dependency . . . bears to the sum"); IND. CODE ANN.

generally would be to the caring parent,[18] with the abandoning parent usually excluded from recovery based on a fact specific standard of dependency.[19]

---

§ 34-1-1-8 (West Supp. 1992) ("according to their respective losses"); KAN. STAT. ANN. §§ 60-1902, 1903 (1983 & Supp. 1992) ("who has sustained a loss" "but the amounts of their respective recoveries shall be fair and just under all the facts and circumstances"); MD. CODE ANN., CTS & JUD. PROC. § 3-904 (1989); MINN. STAT. ANN. § 573.02 (West 1988) ("court determines proportionate pecuniary loss"); MO. ANN. STAT. § 537.090 (Vernon 1988); NEB. REV. STAT. § 30-810 (Supp. 1992) ("in the proportion that the pecuniary loss suffered by each bears to the total"); NEV. REV. STAT. ANN. § 41.085 (Michie 1986) ("heirs may prove their respective damages . . . and the court or jury may award each person pecuniary damages"); N.J. STAT. ANN. § 2A: 31-4 (West 1987); N.Y. EST. POWERS & TRUSTS § 5-4.4 (McKinney Supp. 1993) ("to the persons entitled thereto in proportion to the pecuniary injuries suffered by them"); N.D. CENT. CODE § 32-21-02 (1976) ("such damages . . . proportionate to the injury resulting from the death to the persons entitled to the recovery"); OHIO REV. CODE ANN. § 2125.03 (Anderson Supp. 1992) ("the court shall adjust the share of each beneficiary" as is equitable); OKLA. STAT. ANN. tit. 12, §§ 1053, 1055 (West 1988) ("distributed according to their grief and loss of companionship"); OR. REV. STAT. §§ 30.040, 30.050 (1988) ("to each beneficiary in accordance with the beneficiary's loss"); S.D. CODIFIED LAWS ANN. § 21-5-8 (1987) ("amount . . . shall be apportioned among the beneficiaries . . . as shall be fair and equitable, having reference to the age and condition of such beneficiaries"); TEX. CIV. PRAC. & REM. CODE ANN. § 71.010 (1986) ("shall be divided, in shares as found by the jury"); UTAH CODE ANN. § 78-11-6 (Supp. 1992); VT. STAT. ANN. tit. 14, § 1492 (1989); VA. CODE ANN. §§ 8.01-53, -54 (Michie 1992) ("shall specify the amount or proportion to be received by each of the beneficiaries'); WASH. REV. CODE ANN. § 4.24.010 (West 1988) ("This section creates only one cause of action, but if the parents of the child . . . are separated damages may be awarded to each plaintiff separately , as the court finds just and equitable"); WYO. STAT. § 1-38-102 (1977) ("Every person . . . may prove his respective damages, and the court or jury may award such person that amount of damages to which it considers such person entitled").

Some of these jurisdictions award certain damages to the decedent's heirs or estate. *See, e.g.*, OKLA. STAT. ANN. tit. 12, § 1053(B) (West 1988); OR. REV. STAT. § 30.030(5) (1988).

18. This assumes that in a dependency-based standard a custodial parent can recover for the loss of the child's society and companionship and not just actual financial losses. Although this was not always the case, most jurisdictions do now allow parental recovery. *See* Lehrbaum-Weiss, *supra* note 13, at 804. *Cf. In re* Estate of Hines, 573 P.2d 1260 (Or. App. 1978) (abandoning parent was entitled to a share since the non-abandoning parent did not prove dependency).

19. It seems axiomatic that if there is no ongoing relationship, there is no loss of society or companionship. "Although surviving parents in a wrongful death action are entitled to a presumption of pecuniary injury in the loss of a child's society, that presumption may be rebutted by presenting evidence that a parent and child were estranged." Gabriel v. Illinois Farmers Ins. Co., 525 N.E.2d 864, 867 (Ill. App. Ct. 1988). *See also* Lovely v. Rahway Hosp., 548 A.2d 242 (N.J. Super. 1988) (court found mother was partially dependent on her minor son and therefore in distributing proceeds, court could by statute vary from the equal intestate distribution, giving father who had only minimal contacts with his son 20% of the award while mother received 80%); Glasco v. Fire Cas. Ins. Co., 709 S.W.2d 550 (Mo. Ct. App. 1986) (90-10 split between mother and father where father failed to support child).

In some states with a dependency-based standard, the statute provides that abandonment or lack of support bars that parent's interest. *E.g.*, VT. STAT. ANN. tit. 14, § 1492(c) (1989); IND. CODE § 34-1-1-8 (West Supp. 1992). *But cf.* Black v. Reynolds, 707 P.2d 388 (Idaho 1985) (interpreting statutory language of "but if either the father or mother. . . has abandoned his or her

Nevertheless, a significant number of jurisdictions provide for a distribution pursuant to or parallel to an intestate or estate distribution,[20] with some jurisdictions excluding an abandoning parent by statute.[21] In our hypothetical of a minor accident victim, most states with the intestate distribution would make no distinction between an abandoning parent and a caring parent. Thus, approximately one-quarter of the states ignore the voluntary abandonment.[22]

A traditional purpose of wrongful death statutes is to compensate survivors for their losses due to the decedent's death. The measure of a statute's success depends in the first instance on the class of beneficiaries designated as distributees therein.[23] To the extent the class is described by dependency, the

---

family, the other is entitled to sue alone" not to deprive a sole abandoning parent from maintaining action). *See also* Emile F. Short, Annotation, *Parent's Desertion, Abandonment or Failure to Support Minor Child As Affecting Right or Measure of Recovery for Wrongful Death of Child*, 53 A.L.R.3D 566 (1973).

20. *See* ALA. CODE § 6-5-410 (1975) ("The damages recovered . . . must be distributed according to the statute of distributions"); COLO. REV. STAT. ANN. § 13-21-201(c) (West 1989) ("by the father and mother . . . each shall have an equal interest in the judgment"); CONN. GEN. STAT. ANN. § 45a-448 (West Supp. 1993) ("shall be distributed as personal estate in accordance with the last will and testament of the deceased if there is one or, if not, in accordance with the law concerning the distribution of intestate personal estate"); GA. CODE ANN. § 51-4-4, § 19-7-1(c) (1991) ("Unless a motion is filed . . . , judgment shall be divided equally between the parents"); IOWA CODE ANN. 633.336 (West 1992) ("shall be disposed of as personal property belonging to the estate of the deceased"); KY. REV. STAT. ANN. § 411.130 (Michie/Bobbs-Merrill 1992) ("to the mother and father of the deceased, one (1) moiety each, if both are living"); LA. CIV. CODE ANN. art. 2315.1 (West Supp. 1993); ME. REV. STAT. ANN. tit. 18A, § 2-804 (West Supp. 1992) ("to the deceased's heirs to be distributed as provided in section 2-106"); MASS. GEN. LAWS ANN. ch. 229, §§ 1, 2 (West 1986 & Supp. 1993) ("to the use of the next of kin"); MISS. CODE ANN. § 11-7-13 (Supp. 1992) ("the damages shall be distributed equally to the father, mother, brothers and sisters, or such of them as the deceased may have living at his or her death:); N.H. REV. STAT. ANN. § 556:14 (1974) ("damages recovered . . . shall become a part of the decedent's estate and be distributed in accordance with the applicable provisions of law"); N.M. STAT. ANN. § 41-2-3 (Michie 1989) ("if such deceased be a minor, childless and unmarried, then to the father and mother, who shall have on equal interest in the judgment"); N.C. GEN. STAT. § 28A-18-2 (1985) ("but shall be disposed of as provided in the Intestate Succession Act"); 42 PA. CONS. STAT. ANN. § 8301(b) (1982) ("The damages recovered shall be distributed to the beneficiaries in the proportion they would take the personal estate of the decedent in case of intestacy"); R.I. GEN. LAWS § 10-7-2 (Supp. 1992) ("to the next of kin, in the proportion provided by law in relation to the distribution of personal property left by persons dying intestate"); S.C. CODE ANN. § 15-51-40 (Law. Co-op. 1976) ("And the amount so recovered shall be divided among the before-mentioned parties in such shares as they would have been entitled to if the deceased had died intestate and the amount recovered had been personal assets of his or her estate.").

This listing may be overstated as a practical matter. For example, Georgia now provides that with respect to cases involving children, the mother or father can petition the court to vary the otherwise equal distribution. GA. CODE ANN. § 19-7-1(c)(6) (1991).

21. *See, e.g.*, N.C. GEN. STAT. § 31A-2 (1984); CONN. GEN. STAT. ANN. § 45a-439(a)(1) (West Supp. 1993); 20 PA. CONS. STAT. ANN. § 2106(b) (Supp. 1993).

22. Those states would include those listed at *supra* note 20, other than those listed at *supra* note 21.

23. Virtually all jurisdictions base the core group of possible claimants on marriage or

subjective analysis greatly assists in achieving the statute's goal. To the extent that class is based strictly on the intestate statutes, the wrongful death distribution suffers the same systemic inflexibility as intestacy.

II. JUDICIAL INTERPRETATION: WHAT MAKES A "PARENT?"

Even if the intestate rules apply in our hypotheticals, it does not necessarily follow that an abandoning parent must inherit from the child or through the wrongful death statute. Judicial interpretation of statutes to effect their purpose is commonplace. Yet in the few reported cases dealing with an abandoning parent as an intestate distributee the courts have uniformly upheld that parent's interest.[24]

Recently, in *Hortarek v. Benson* (our second hypothetical), the Connecticut Supreme Court followed a predictable legal analysis: man and woman marry; they have a child; they divorce; no termination of parental rights occurs; the child dies; therefore the parents share equally in the child's estate. The Connecticut Supreme Court stated that in this "unique and tragic"[25] case "we have no power"[26] [to consider abandonment] since the "law governing descent and distribution . . . is purely statutory."[27] It agreed with the lower court that "there is neither common law nor statutory law upon which relief can be granted."[28]

This is a tragic case for the father who was the custodial parent. He has lost his child. It is also a tragic case for the legal system, since the legal system seems only to compound his grief and invites derision. While the court seemed to march reluctantly to this result, it nevertheless reached its

---

blood relationships. *See, e.g.*, states listed in *supra* notes 17 and 20.

24. For this purpose I use "intestate distributee" to mean the parent receiving directly from the intestate estate as heir or pursuant to a wrongful death statute that uses an intestate distribution scheme. The cases include Heggie v. Barley, 5 Tenn. C.C.A. 78 (1914); *In re* Green's Estate, 196 N.W. 993 (Iowa 1924), discussed in Note, 10 VA. L. REV. 650 (1924); Avery v. Brantley, 131 S.E. 721 (N.C. 1926), discussed in J.C. Kesler, Note, 5 N.C. L. REV. 72 (1926); Murphy v. Duluth-Superior Bus Co., 274 N.W. 515 (Minn. 1937); Brady v. Fitzgerald, 90 So. 2d 182 (Miss. 1956); Anderson v. Anderson, 366 S.W.2d 755 (Tenn. 1963); Pogue v. Pogue, 434 So. 2d 262 (Ala. Civ. App. 1983); Estate of Rozet, 504 A.2d 145 (N.J. 1985); Crosby v. Corley, 528 So. 2d 1141 (Ala. 1988) (abandoning parent's share upheld even with evidence of mental, physical and sexual abuse by the parent); and Hotarek, *supra* note 2.

25. 557 A.2d at 1260.

26. *Id.* at 1263.

27. *Id.* at 1261.

28. *Id.*

conclusion unequivocally.[29] Despite this unanimity, it could have held differently.

It is the duty of judges in our tradition to interpret and apply the law based on the particular facts before them.[30] It is not sufficient to say the law is "purely statutory," even statutes need interpretation. One need look no further than the Internal Revenue Code to see the superficiality of that argument. A long line of cases exist—the "on-the-other-hand" analysis—that sanction a fresh look at statutory or traditional legal doctrine.[31] This analysis does not abandon or ignore a statute. Rather, it applies the statute to a new fact pattern consistent with the spirit of the statute and the aims of society. It is an especially common technique in "unique" cases.

This analysis seems particularly appropriate here, for two reasons. First, significant compensatory personal injury cases and wrongful death cases are relative newcomers to our legal system,[32] and hence there is little long-standing common law with respect to them. Second, the minor and incapacitated decedents in our hypotheticals are by definition locked into the intestate scheme; they cannot exit by signing wills.[33]

The "on-the-other-hand" analysis is simply a recognition of the dynamic nature of the common law.[34] Statutes as well as common law rules have

---

29. BENJAMIN N. CARDOZO, THE GROWTH OF THE LAW 66 (1924): "Judges march at times to pitiless conclusions under the prod of a remorseless logic which is supposed to leave them no alternative. They deplore the sacrificial rite. They perform it, none the less, with averted gaze, convinced as they plunge the knife that they obey the bidding of their office. The victim is offered up to the gods of jurisprudence on the altar of regularity."

30. BENJAMIN N. CARDOZO, THE NATURE OF THE JUDICIAL PROCESS 14 (1921): "It is true that code and statutes do not render the judge superfluous, nor his work perfunctory and mechanical. There are gaps to be filled. There are doubts and ambiguities to be cleared. There are hardships and wrongs to be mitigated if not avoided." Also: "The judge as the interpreter for the community of its sense of law and order must supply omissions, correct uncertainties, and harmonize results with justice. . . ." *Id.* at 16. "[Interpretation] supplements the declaration, and fills the vacant spaces, by the same processes and methods that have built up the customary law." *Id.* at 17.

31. For true textbook applications, *see e.g.*, Lister v. Smith, Court of Probate 1863, 3 SW. & Tr. 282, 164 Eng. Rep. 1282; Eaton v. Brown, 193 U.S. 411 (1904); Pope v. Garrett, 211 S.W.2d 559 (Tex. 1948); cited in JOHN RITCHIE ET AL., DECEDENTS' ESTATES AND TRUSTS (8th ed. 1993) at 406, 409, and 438, respectively.

32. *See supra* notes 13-23 and accompanying text. For example, only in 1955 did Illinois remove the cap on wrongful death recoveries. *See* Kenneth Siegan, Comment, *Wrongful Death Recovery Limitations—R.I.P.*, 17 DEPAUL L. REV. 385 (1968); James T. Demos, *Measure of Damages—Wrongful Death*, 60 ILL. B.J. 518 (1972).

33. UNIFORM PROBATE CODE 36 (7th ed. 1987): "While the prescribed patterns may strike some as rules of law which may in some cases defeat intent of a decedent, this is true of every statute of this type. In assessing changes it must therefore be borne in mind that the decedent may always choose a different rule by executing a will."

34. For an excellent exposition of this view, *see* William N. Eskridge, Jr., *Public Values in Statutory Interpretation*, 137 U. PA. L. REV. 1007 (1989). For a more general presentation of the various theories of statutory interpretation, see Earl M. Maltz, *Rhetoric and Reality in the*

been interpreted for generations to embrace societal needs and desires.[35] When courts fail to interpret statutes consistent with those societal aims when clear legislative intent is lacking, they fail in their institutional duty to declare the common law.[36]

Following the on-the-other-hand approach, the Connecticut court could have interpreted the relevant statutory phrase "parent or parents of the intestate" to exclude those biological or adoptive parents who voluntarily abandon their children, by not participating in the care, nurture, guidance and support of their children. A court could interpret "parent" less biologically and more functionally based on a de facto definition that recognizes the duality inherent in "parent": the act of becoming a parent (birth or adoption) coupled with the acts of being a parent (care and nurturing of the child).[37] This would be more consistent with today's view of a functioning parent-child relationship[38] and would seek to promote "a view of parenthood based on responsibility and connection,"[39] rather than feudal notions of bloodlines and

---

Theory of Statutory Interpretation: Underenforcement, Overenforcement, and the Problem of Legislative Supremacy, 71 B.U. L. REV. 767 (1991).

35. See Justice Holmes' classic statement: "A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used." Towne v. Eisner, 245 U.S. 418, 425 (1918). Chief Justice Robert N. Wilentz of the New Jersey Supreme Court affirmed the principle: "Our court has been working to make sure the common law corresponds to present societal values." Joseph F. Sullivan, *New Jersey Seen as Leader on Rights*, N.Y. TIMES, July 18, 1990, at B1.

36. *See supra* note 29. "The true science of law does not consist mainly in a theological working out of dogma or a logical development as in mathematics, or only in a study of it as an anthropological document from the outside; an even more important part consists in the establishment of its postulates from within upon accurately measured social desires instead of tradition." Oliver W. Holmes, *Law in Science and Science in Law*, *in* COLLECTED LEGAL PAPERS 225-26 (1920).

37. At least one trial court has ventured into this arena to bar an unworthy parent ("the trial court *ex mero motu* entered an order finding that appellant had forfeited his rights as a parent because of his repeated acts of physical, mental, and sexual abuse against"[his daughter]), but its "novel effort to avoid what may be perceived as harsh inequities caused by the blind application of the distribution statute . . . " was reversed on appeal. Crosby v. Corley, 528 So.2d 1141, at 1142-44. In Lawson v. Atwood, 536 N.E.2d 1167 (Ohio 1989) a child's caregiver of 16 years was held to be a "parent" for purposes of the Ohio wrongful death act where (1) the natural parents had disclaimed or abandoned the child, (2) the caregiver had performed the obligations of parenthood for a substantial period of time, (3) the child and caregiver had held themselves out to be child and parent for a substantial period of time; and (4) the relationship between them had been publicly recognized. Although neither natural parent was before the court, the practical implication of the holding presumably is to bar the abandoning parent from participating in the recovery.

38. *See, e.g.*, JOSEPH GOLDSTEIN ET AL., BEYOND THE BEST INTERESTS OF THE CHILD 9-28 (1973) (discussing biological and psychological parents); Larry Rohter, *Natural vs. Adoptive: A Girl Tests the Limits*, N.Y. TIMES, July 30, 1993, at B10.

39. Katharine T. Bartlett, *Re-Expressing Parenthood*, 98 YALE L.J. 293, 295 (1988). An enormous pool of literature addressing basic questions on the changing notion of family law and

property rights. Thus unless a person fulfilled both aspects of the parent definition, he or she would not be considered a parent for purposes of inheritance from the child. Stated another way, "parent" in the context of this statute would be imbued with an equitable norm: unless a parent fulfills his or her parental duties and responsibilities, the parent loses the parental benefits of the relationship.[40] No less a historic common law authority than Blackstone acknowledged the duties of parents *with* a correlative diminution of rights in property if those duties were not fulfilled:

> It is a principle of law, that there is an obligation on every man to provide for those descended from his loins. . . . [A]nd if a parent runs away, and leaves his children, the churchwardens and overseers of the parish shall seize his rents, goods, and chattels, and dispose of them towards their relief.[41]

Judicial interpretation, of course, has the advantage of keeping the statutory language intact yet flexible. The judge is not engrafting a requirement or creating an exception, rather she is interpreting the words in the spirit of the legislature and society to the new fact pattern before her. Justice could be served immediately, and not only after the legislature enacts a statutory

---

relationships is emerging. *E.g.*, MARY ANNE GLENDON, THE TRANSFORMATION OF FAMILY LAW: STATE, LAW, AND FAMILY IN THE UNITED STATES AND WESTERN EUROPE (1989); Carl E. Schneider, *Moral Discourse and the Transformation of American Family Law*, 83 MICH. L. REV. 1803 (1985). Notable in this regard is the decision of the New York Court of Appeals in Braschi v. Stahl Assoc., 74 N.Y.2d 201, 544 N.Y.S. 2d 784 (1989), where that Court determined the gay life partner of the deceased tenant was a member of the decedent's "family" for purposes of the New York rent control laws. The court determined that "it is the totality of the relationship as evidenced by the dedication, caring and self-sacrifice of the parties which should, in the final analysis, control." *Id.* at 790.

40. *See* Lawson v. Atwood, 536 N.E.2d 1167 (Ohio 1989). Analogous reasoning was applied in Allen v. Allen, 738 P.2d 142 (Okla. 1987), where the Oklahoma Supreme Court held that a woman who was legally married to the decedent was equitably estopped from taking her spousal share since she had undertaken a common law marriage to another man. In other words, the act of becoming a wife was not sufficient when the acts of being a wife were absent. *See* Comment, 41 OKLA. L. REV. 128-32 (1988).

41. 1 WILLIAM BLACKSTONE, COMMENTARIES *436. For a more contemporary citation, consider Rose v. Rose, 481 U.S. 619 (1987) where the Court held that the federal anti-attachment provision did not insulate Veterans' Administration benefits from the claims of child support. See especially Justice O'Connor's concurrence: "Our Anglo-American tradition accords a special sanctity to the support obligation." 481 U.S. at 637. *See also* Eskridge, *supra* note 34 at 1058-60.

amendment.[42] As Judge Learned Hand observed, there is little justice served in making a "fortress out of a dictionary."[43]

A traditional argument against the on-the-other-hand analysis is the lack of certainty generated by its application. There are two responses to this argument. First, the on-the-other-hand analysis is not applied in routine cases; routine cases do require simple certain rules. Rather, the on-the-other-hand analysis should apply only to a narrow band of egregious cases, for example, that of the murdering heir. Judicial activism is not to be feared more than an acknowledged inequitable distribution. Second, the level of proof required to show abandonment should be fairly high. A clear and convincing standard would be appropriate, and the burden of proof would be on those asserting abandonment.[44] Some factors indicative of abandonment would be the voluntary change of residence, the lack of financial support, and few or no contacts with the child. Although the situation of an abandoning parent and a deceased intestate child is not unique,[45] it nevertheless is not so common that we need fear judicial overload.[46]

---

42. An analogy to the abandoning parent is the murdering heir inheriting from his victim. Though no one deemed it just, when confronted with the dilemma many courts felt powerless to vary from the literal words of the intestate statute. *E.g.*, Bird v. Plunkett, 95 A.2d 71 (Conn. 1953). Other courts viewed their role differently. *E.g.*, DeZotel v. Mutual Life Ins. Co., 245 N.W. 58, 65 (S.D. 1932):

> We cannot persuade ourselves that there ever was any legislative intent that our statutes of descent and succession, general or special, however broad and unambiguous and lacking in exceptions in their terms, should operate in favor of a sane, felonious killer. We announce it as the law of this state that such statutes will not be permitted to so operate unless and until the Legislature shall specifically and affirmatively so enact.

Still other courts found a remedy in the constructive trust where technical title passed to the wrongdoer, but was immediately impressed with a trust for others' benefit. *E.g.*, Estate of Mahoney, 220 A.2d 475 (Vt. 1966). Today most jurisdictions have a statute barring the murdering heir from inheriting. Jeffrey G. Sherman, *Mercy Killing and the Right to Inherit*, 61 U. CIN. L. REV. 803, 805 (1993).

43. Cabell v. Markham, 148 F.2d 737, 739 (2d Cir. 1945), *aff'd*, 326 U.S. 404 (1945): "But it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of a dictionary; but to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning."

44. *See, e.g.*, *In re* Estate of Clark, 501 N.Y.S. 2d 479 (1986), but consider Ohio's "by a preponderance of the evidence" standard. *See infra* note 90.

45. Interestingly, of the cases listed at *supra* note 24 only *Hotarek* and *Crosby* cited any of the other decisions.

46. "The legislature, by mandating that wrongful death proceeds be distributed according to the statute of intestate distribution, necessarily perceived that some beneficiaries would be totally unworthy of inheriting. . . . The distributions listed in the statute mandate who shall inherit, without exceptions. The probate process necessitates such mandates in order to simplify the process and avoid floods of litigation over who the deceased would have intended to inherit." Crosby v. Corley, 528 So. 2d 1141, 1143 (Ala. 1988).

III. COMMON LAW: IS INDIGNITAS A VIABLE THEORY?

When confronted with an issue of statutory interpretation, and in the absence of clear legislative intent and case precedent, courts often seek a common law rule or theory upon which to fashion a resolution. In the situation of an abandoning parent inheriting *from* an abandoned child, the traditional common law has no such readily engrafted rule. This is not because the common law favored abandonment[47] but, doubtless, due to the *descending* notion of inheritance. After all, Blackstone's first canon of descent provides: "The first rule is, that inheritances shall lineally descend to the issue of the person who last died actually seised, in infinitum; but shall never lineally ascend."[48] Thus, Blackstone's first canon of descent does provide support for a court's statement that "there is [no] common law . . . upon which relief can be granted. . . ."[49]

Yet, the common law rules of descent were restricted to real property; and feudalism, with military service tied to the feudal grant, was fundamental in their development.[50] With respect to personalty however, the rules of distribution that were followed were those of "customary law, which agreed with the civil law, as it existed before the time of Justinian. . . ."[51]

The ecclesiastical courts exercised jurisdiction over the distribution of personalty, following "the rules of the civil law."[52] This being so, an

---

47. *See supra* note 41. Also consider the Statute of Westminster II, 1285, 13L.dw. I, ch. 34, which provided that if a woman left her husband and continued to live in adultery, she was barred of dower unless her husband voluntarily permitted her to return to his house. Atkinson, *supra* note 4, at 148-50. Some jurisdictions today have statutes barring inheritance of an abandoning or adulterous spouse. *E.g.*, N.C. GEN. STAT. § 31A-1 (1984).

48. 2 WILLIAM BLACKSTONE, COMMENTARIES *208.

49. *Hotarek*, 557 A.2d at 1261.

50. 2 WILLIAM BLACKSTONE, COMMENTARIES *210-12:

> But the negative branch, or total exclusion of parents and all lineal ancestors from succeeding to the inheritance of their offspring is peculiar to our own laws. . . . Hence this rule of our law has been censured and declaimed against, as absurd and derogating from the maxims of equity and natural justice. Yet that there is nothing unjust or absurd in it, . . . may appear from considering as well as the nature of the rule itself, as the occasion of introducing it into our laws. . . . [It] was introduced at the same time with, and in consequence of, the feodal tenures. . . . [Also] upon this consideration of military policy, that the decrepit grandsire of a vigorous vassal would be but indifferently qualified to succeed him in his feodal service.

See also Carole Shamas, *English Inheritance Law and Its Transfer to the Colonies*, 31 AM. J. LEGAL HIST. 145 (1987).

51. W. D. Rollison, *Principles of the Law of Succession to Intestate Property*, 11 NOTRE DAME L. REV. 14, 18 (1935-36). *See also* ALISON REPPY & LESLIE J. TOMPKINS, HISTORICAL AND STATUTORY BACKGROUND OF THE LAW OF WILLS: DESCENT AND DISTRIBUTION PROBATE AND ADMINISTRATION 7 (1928).

52. Rollison, *supra* note 51, at 19. For an overview of the historic development of the common law, *see* Franz Wieacker, *The Importance of Roman Law for Western Civilization and Western Legal Thought*, 4 B.C. INT'L & COMP. L. REV. 257 (1981).

investigation of potentially useful doctrine or theory in the civil law regime is appropriate.[53]

Ancient Roman law, a primary source of the civil law,[54] recognized a doctrine of *indignitas*, whereby one who would otherwise receive property from the deceased was prohibited from receiving it because he was deemed "unworthy to receive it."[55] For example, "a tutor by will [roughly a guardian of an estate] who excused himself lost any benefit under the will, as did anyone who attacked the will unsuccessfully, and one who accepted a legacy under a secret trust in favor of one who could not take" would be considered *indignus*.[56] Speaking more generally "any act in fraud of the law induced a forfeiture."[57] *Indignitas* as a doctrine is not confined to ancient history; there is evidence of the continued existence and viability of this doctrine in civil law regimes today.[58] In the American system, Louisiana continues this tradition: "They are called unworthy in matters of succession, who, by the failure in some duty towards a person, have not deserved to inherit from him, and are in consequence deprived of his succession."[59]

Research has not uncovered any reported instance in Roman law of an abandoning parent specifically being deemed *indignus* because of the abandonment. This is not surprising given the Roman law structure of *patria*

---

53. William W. Bassett, *Canon Law and Common Law*, 29 HASTINGS L. REV. 1383 (1978). *But see* Alison Reppy, *The Slayer's Bounty - History of Problem in Anglo-American Law*, 19 N.Y.U. L. REV. 229, 266-67 (1942) for discrediting a similar attempt in the murderous heir situation:

> It is evident, therefore, that Justice Earl thought that no statute was necessary for the reason that the rule that a slayer could not profit from his crime could be taken from the civil law and engrafted upon the common law, or, failing this, the same result could be attained by finding that the rule of the civil law, or the rule of public policy, as the case may be, could be discovered in "the maxims of the common law." It seems clear, that in holding [against the murderous beneficiary, the judge] was greatly influenced by the civil law, and was determined to apply the so-called rule of public policy as founded upon the civil law, or extracted from "the Maxims of the common law," which, as one distinguished scholar once remarked, are "waste baskets for loose legal thinking."

54. *See, e.g.*, HENRY SUMNER MAINE, ANCIENT LAW 165-208 (1875); JOHN HENRY MERRYMAN, THE CIVIL LAW TRADITION 7-14 (1969); Jacob Dolinger, *A Civil Lawyer Looks at a Common Law Lawyer's Views on Civil Law: John Henry Merryman's The Civil Law Tradition*, 17 BROOK. J. INT'L L. 557, 567 (1991); BARRY NICHOLAS, AN INTRODUCTION TO ROMAN LAW 235-270 (1962).

55. MAX RADIN, HANDBOOK OF ROMAN LAW 437-39 (1927); *see also* ADOLF BERGER, ENCYCLOPEDIC DICTIONARY OF ROMAN LAW 499 (43 Transactions of the American Philosophical Society, 1953).

56. WILLIAM W. BUCKLAND, A TEXT-BOOK OF ROMAN LAW 317 (1921).

57. RADIN, *supra* note 55, at 438.

58. The concept of *indignitas* continues in many foreign civil law jurisdictions. *See, e.g.*, the ITALIAN CIVIL CODE, C.c. §§ 463-66 (Dell' indegnità).

59. LA. CIV. CODE ANN. art. 965 (West 1952).

potestas, which included the notion that property ownership was in the head of the family, *pater familias*, and not in an unemancipated child.[60]

Using fragments of legal history does not present a conclusive analysis, or an academically desirable and neat "if-then" equation.[61] Yet the statement "there is [no] common law . . . upon which relief can be granted"[62] is equally problematic. The modern day lack of understanding of the role of ecclesiastical courts (who were the losers in the battle for judicial preeminence in England),[63] the scant written records of those courts, the relative lack of personalty as wealth, and the descending nature of intestate succession, all contribute to a myopic view of the common law. By according "recognition to the intrinsic importance to the development of the law of England of the jurisdiction once exercised by the courts of the Church,"[64] we open up the possibility of a common law *theory* granting relief, fully recognizing there is no common law *rule* granting relief. Our legal system, which strives to recognize the pluralistic society in which we live today, could gain in public esteem by recognizing the pluralistic roots of its past.[65]

In fashioning a decision in a case today, a court must recognize a parent's legal duty to support a child.[66] This duty coupled with the ancient but

---

60. BUCKLAND, *supra* note 56, at 102-04. Also until very recently, Louisiana specifically provided that a child could disinherit a parent for seven reasons, including if "a parent has refused sustenance to the child in necessity having the means of affording it." LA. CIV. CODE ANN. art 1632 (West 1987), repealed by Acts 1990 No. 147, § 3 (effective July 1, 1990). As only descendants are now forced heirs in Louisiana, the child's parental disinherison statute was presumably unnecessary. *See* LA. CIV. CODE ANN. arts. 1493, 1494 (West Supp. 1993). *See also* Leonard Oppenheim, *The Revocation of a Testamentary Disinherison*, 16 TUL. L. REV. 97 (1941) ("There is no reported instance of an attempt by a child to disinherit one or both of his parents.").

61. There is debate as to the degree of influence of Roman law, civil law, and canon law on the common law. For a somewhat irreverent linguistic dissection of traditional homage to Roman law, see DAVID DAUBE, ROMAN LAW: LINGUISTIC, SOCIAL AND PHILOSOPHICAL ASPECTS (1969).

62. Hotarek v. Benson, 557 A.2d 1259, 1261 (Conn. 1989).

63. R. H. HELMHOLZ, CANON LAW AND ENGLISH COMMON LAW 3 (1983) (Selden Society Lecture, July 5, 1982).

64. *Id. See also* Bassett, *supra* note 53, at 1412-13: "The canonists gave to our modern legal system the law of wills and probate administration. . . the law of family and domestic relations, and the law of trusts." "Neither the ancient feudal laws nor the Justinianean corpus focused upon the individual person. . . . The humanity in the laws today comes from the example set by the canonists within their own system, in the courts Christian, and in Chancery." *Id.* at 1414.

65. "The mere recognition of the truth that there are more methods to be applied than one, that there is more than one string to harp upon, is in itself a forward step. . . ." BENJAMIN N. CARDOZO, THE GROWTH OF THE LAW 64 (1924).

66. Not only is there a legal duty for parents to support a child, there is growing public awareness and insistence that parental support obligations be honored and that legal mechanisms for enforcement of that duty be strengthened. In responding to this concern, Representative Christopher Cox has recently proposed a rather innovative approach, requiring unpaid child support to be included in the delinquent parent's gross income for income tax purposes. H.R. 2355, 103rd

continuing doctrine of *indignitas* could lead a willing and bold court to declare that a parent's abandonment of a child is an "act in fraud of the law," making that parent unworthy to inherit from the child. More likely than this direct equitable application of *indignitas*, a willing but less bold court could cite the doctrine as support for interpreting "parent" in an equitable and functional fashion.

IV. Abandonment Statutes

A. Current Models for Abandonment Statutes

Given the general reluctance of courts to pursue either an interpretive or a civil law-common law model of analysis in circumstances of abandonment, statutory approaches provide a recognized and concrete remedy. Current statutory approaches with varying degrees of commonality and scope exist and will be examined.

At least six jurisdictions provide directly for a statutory forfeiture of an abandoning parent's interest in a child's intestate estate.[67] These statutes will be briefly discussed. Thereafter, an overall analysis of the statutory models will follow.

1. North Carolina.—In the 1926 case of *Avery v. Brantley*,[68] the North Carolina Supreme Court determined that a father who had abandoned his daughter was nevertheless entitled to inherit in the wrongful death action of his four-year old daughter. The North Carolina wrongful death statute provided that distribution was to be made as in the case of intestacy of personal property.[69] The legislative response was swift. In 1927, North Carolina enacted a straightforward proviso to its intestate rule of inheritance from a child who leaves no spouse or descendant: "Provided, that a parent, or parents, who has willfully abandoned the care, custody, nurture and maintenance of such child to its kindred, relatives or other person, shall forfeit all and every right to participate in any part of said child's estate under the provisions of this section."[70]

Over time this statute has been modified. In 1961, North Carolina revised this enactment in two substantive respects.[71] First, a resumption of care and maintenance by the parent for at least one year prior to the child's death that

---

Cong., 1st Sess. (1993). *See also* Roberts, *supra* note 1.

67. They are Connecticut, North Carolina, New York, Ohio, Pennsylvania and Virginia, cited *supra* note 11.

68. 131 S.E. 721 (N.C. 1926).

69. *Id.* at 722. A similar rule is in effect today. N.C. Gen. Stat. § 28A-18-2 (1984).

70. N.C. Publ. Laws ch. 231 (1927).

71. N.C. Gen. Stat. § 31A (1961). *See* W. Bryan Bolich, *Acts Barring Property Rights*, 40 N.C. L. Rev. 175, 182-85 (1962).

continues until the child's death provides an exception to the rule of forfeiture. The second modification provides that if a parent is deprived of the child's custody by a court and that parent substantially complies with the court ordered support, the parent may inherit from the child.[72] The North Carolina statute now reads as follows:

> Any parent who has wilfully abandoned the care and maintenance of his or her child shall lose all right to intestate succession in any part of the child's estate and all right to administer the estate of the child, except —
>
> (1) Where the abandoning parent resumed its care and maintenance at least one year prior to the death of the child and continued the same until its death; or
>
> (2) Where a parent has been deprived of the custody of his or her child under an order of a court of competent jurisdiction and the parent has substantially complied with all orders of the court requiring contribution to the support of the child.[73]

2. New York.—The New York statute[74] lacks the obviously reactive origins of the original North Carolina statute; yet as the New York legislation was recommended by the Surrogates' Association it may in fact be reactive.[75] Originally enacted in 1941, the New York statute's intent was "to deprive a parent of a distributive share in the estate of a child or of a share in the damages recovered for the wrongful death of a child where such parent has abandoned the child during infancy or has neglected or refused to provide for such child during infancy."[76]

It now provides:

---

72. The necessity for this modification may not be readily apparent today, but at one time several jurisdictions provided that the custodial parent was the sole heir of the personal property of a deceased child. *See, e.g.*, TENN. CODE ANN. § 31-201(4) (1955), discussed in Ray v. Chandler, 482 S.W.2d 553 (Tenn. 1972); Douglas P. Quay, Note, *Intestate Succession in Tennessee*, 8 MEM. ST. U. L. REV. 63, 73-74 (1977-78). This may be the underlying reason for the modification.

73. N.C. GEN. STAT. § 31A-2 (1984).

74. N.Y. EST. POWERS & TRUSTS LAW § 4-1.4 (McKinney 1981).

75. Patrick J. Rohan & Samuel Hoffman, *Practice Commentary to N.Y. Est. Powers & Trusts Law* § 4-1.4, at 744 (McKinney 1981 & Supp. 1993).

76. 1941 N.Y. LAWS ch. 89, p. 173 fn. As enacted, the law provided, "No distributed share of the estate of a decedent shall be allowed under the provision of this article. . .

> (e) or in the estate of child to a parent who has neglected or refused to provide for such child during infancy or who has abandoned such child during infancy whether or not such child dies during infancy, unless the parental relationship and duties are subsequently resumed and continue until the death of the child."

> No distributive share in the estate of a deceased child shall be allowed to a parent who has failed or refused to provide for, or has abandoned such child while such child is under the age of twenty-one years, whether or not such child dies before having attained the age of twenty-one years, unless the parental relationship and duties are subsequently resumed and continue until the death of the child.[77]

3. Pennsylvania.—In 1984, more than fifty years after the original North Carolina legislation, Pennsylvania included in its intestate forfeiture statute a provision regarding parents as follows:

> Any parent who, for one year or upwards previous to the death of the parent's minor or dependent child, has willfully neglected or failed to perform any duty of support owed to the minor or dependent child or who, for one year, has willfully deserted the minor or dependent child shall have no right or interest under this chapter in the real or personal estate of the minor or dependent child.[78]

4. Connecticut.—In May 1989, as part of its *Hotarek* decision, the Connecticut Supreme Court urged the legislature to revise the intestate rules.[79] The Connecticut legislature reacted quickly, as North Carolina's did sixty-three years previously. Unfortunately, its 1990 attempt to pass legislation "was lost at the tail end of the session," although there was no reason for "any objection to it whatsoever."[80] The second legislative attempt in 1991 was successful.[81] Like North Carolina's original 1927 enactment, the method chosen by Connecticut was a proviso to its intestate distribution scheme as follows: "provided no parent who has abandoned a minor child and continued such abandonment until the time of death of such child, shall be entitled to share in the estate of such child. . . ."[82]

5. Virginia.—In 1992, Virginia joined the ranks with its straightforward statute:

> If a parent willfully deserts or abandons his or her minor or incapacitated child and such desertion or abandonment continues until the death of the child, the parent shall be barred of all interest in the estate of the child by intestate succession unless the parent resumes

---

77. N.Y. EST. POWERS & TRUST LAW § 4-1.4 (McKinney 1981).

78. 20 PA. CONS. STAT. ANN. § 2106(b) (Supp. 1993).

79. 557 A.2d, at 1263. "If the law is to be changed to make provision for the situation at hand, it is for the legislature to make the change, not the courts. We urge the legislature to consider doing so."

80. 1991 Conn. Joint Standing Comm. Hearings Judiciary 168, testimony of Ralph Lukens, on February 19, 1991.

81. *See* 34 Conn. Gen. Assembly - Senate Proceedings Part 3, 1044-45 (1991); 34 Conn. Gen. Assembly - House Proceedings Part 7, 2421-23 (1991).

82. CONN. GEN. STAT. ANN. § 45a-439(a)(1) (West Supp. 1993).

the parental relationship and duties and such parental relationship and duties continue until the death of the child.[83]

The Virginia statute reflects the older trilogy of the North Carolina-New York-Pennsylvania statutes rather than the Connecticut proviso version.

6. Ohio.—Also in 1992, Ohio enacted its version of a statutory forfeiture based on parental abandonment.[84] This "simple" legislation had "a clear

---

83. VA. CODE. ANN. § 64.1-16.3(B) (Michie Supp. 1993).

84. OHIO REV. CODE ANN. § 2105.10 (Anderson Supp. 1992). Parent who abandons minor child barred from intestate succession from child; status as next of kin or heir at law.

(A) As used in this section:

(1) "Abandoned" means that a parent of a minor failed without justifiable cause to communicate with the minor, care for him, and provide for his maintenance or support as required by law or judicial decree for a period of at least one year immediately prior to the date of the death of the minor.

(2) "Minor" means a person who is less than eighteen years of age.

(B) Subject to divisions (C), (D), and (E) of this section, a parent who has abandoned his minor child who subsequently dies intestate as a minor shall not inherit the real or personal property of the deceased child pursuant to section 2105.06 of the Revised Code. If a parent is prohibited by this division from inheriting from his deceased child, the real or personal property of the deceased child shall be distributed, or shall descend and pass in parcenary, pursuant to section 2105.06 of the Revised Code as if the parent had predeceased the deceased child.

(C) Subject to divisions (D) and (E) of this section, a parent who is alleged to have abandoned a child who died as an intestate minor shall be considered as a next of kin or an heir at law of the deceased child only for the following purposes:

(1) To receive any notice required to be given to the heirs at law of a decedent in connection with an application for release of an estate from administration under section 2113.03 of the Revised Code;

(2) To be named as a next of kin in an application for the appointment of a person as the administrator of the estate of the deceased child, if the parent is known to the person filing the application pursuant to section 2113.07 of the Revised Code, and to receive a citation issued by the probate court pursuant to that section.

(D)(1) The prohibition against inheritance set forth in division (B) of this section shall be enforceable only in accordance with a probate court adjudication rendered pursuant to this division.

(2) If the administrator of the estate of an intestate minor has actual knowledge, or reasonable cause to believe, that the minor was abandoned by a parent, the administrator shall file a petition pursuant to section 2123.02 of the Revised Code to obtain an adjudication that the parent abandoned the child and that, because of the prohibition against inheritance set forth in division (B) of this section, the parent shall not be considered to be an heir at law of, and shall not be entitled to inherit the real and personal property of, the deceased child pursuant to section 2105.06 of the Revised Code. That parent shall be named as a defendant in the petition and, whether or not that parent is a resident of this state, shall be served with a summons and a copy of the petition in accordance with the Rules of Civil Procedure. In the heirship determination proceeding, the administrator has the burden of proving, by a preponderance of the evidence, that the parent abandoned the child. If, after the hearing, the probate court finds that the administrator has sustained that burden of proof, the probate court shall include in its adjudication described in section 2123.05 of the Revised Code its findings that the parent abandoned the child and, because of the prohibition against inheritance set forth in division (B) of this section, the parent shall not be considered to be an heir at law of, and shall not be entitled to inherit the real and personal property of, the deceased child pursuant to section 2105.06 of the Revised Code. If the probate

purpose"—"to close a gap in Ohio law similar to the one which forced the Conneticut [sic] courts to render their inequitable decision."[85] It is unlike any of the previously discussed versions in its length and extensive definitional and procedural detail. There are five divisions to the statute. Division A defines "abandoned" and "minor."[86] Division B provides that "a parent who has abandoned his minor child who subsequently dies intestate as a minor shall not inherit" from the child.[87] Despite this forfeiture, an abandoning parent shall be considered as a next of kin for certain procedural and administrative purposes pursuant to Division C.[88]

Division D sets forth in three subdivisions the procedure for the court's adjudication of parental abandonment.[89] It specifically requires a formal adjudication by the court of the parental abandonment in order for the disinheritance to be effective. The administrator bears the burden of proof by a preponderance of the evidence.[90] Division E provides that the heirship determination proceedings of Division D must be commenced by the administrator within four months from his receipt of letters, otherwise it may not be commenced.[91]

7. Uniform Probate Code.—Although not a legislatively enacted statute as the six provisions just discussed, the Uniform Probate Code may offer additional insight into the crafting of an abandonment statute. There is no Uniform Probate Code parallel to the straight-forward abandonment provisions just discussed, yet a curious half measure of relief may exist. The most recent version of the Uniform Probate Code describes the parent and child relation-

---

court so finds, then, upon the entry of its adjudication on its journal, the administrator may make a final distribution of the estate of the deceased child in accordance with division (B) of this section.

(3) An heirship determination proceeding resulting from the filing of a petition pursuant to this division shall be conducted in accordance with Chapter 2123 of the Revised Code, except to the extent that a provision of this section conflicts with a provision of that chapter, in which case the provision of this section shall control.

(E) If the administrator of the estate of an intestate minor has not commenced an heirship determination proceeding as described in division (D) of this section within four months from the date that he receives his letters of administration, then such a proceeding may not be commenced subsequently, no parent of the deceased child shall be prohibited from inheriting the real or personal property of the deceased child pursuant to division (B) of this section, and the probate of the estate of the deceased child in accordance with section 2105.06 and other relevant sections of the Revised Code shall be forever binding.

85. Rep. Bergansky, Sponsor Testimony—H.B. 166, 119th Ohio General Assembly Regular Session (1991-1992) 1, undated, from bill file Ohio Legislative Service Commission.

86. *Id.* § 2105.10(A).

87. *Id.* § 2105.10(B).

88. *Id.* § 2105.10(C).

89. *Id.* § 2105.10(D).

90. *Id.* § 2105.10(D)(2) "In the heirship determination proceeding, the administrator has the burden of proving, by a preponderance of the evidence, that the parent abandoned the child."

91. *Id.* § 2105.10(E).

ship in three subsections for purposes of intestacy.[92] The subsections' language is neutral, but reminiscent of concerns about the intestate status of illegitimate children and adopted children. The first subsection provides that for "purposes of intestate succession by, through, or from a person, an individual is the child of his [or her] natural parents, regardless of their marital status."[93] Subsection (b) then makes an adopted individual the child of his or her adopting parents.[94] Finally subsection (c) precludes "inheritance from or through a child by either natural parent or his (or her) kindred . . . unless that natural parent has openly treated the child as his (or hers), and has not refused to support the child."[95]

Subsection (a)'s use of neutral language ("child of his natural parents") is positive, as a step away from the term "illegitimate." When the neutral language is simply inserted in subsection (c), however, the results are questionable and presumably unintended. There is no basis for distinguishing between an abandonment by a natural parent and an abandonment by an adoptive parent. The child is harmed the same. The historical context and language of subsection (c) create an ambiguity as to its intent and scope when applied to our hypotheticals.

B. Analysis of Abandonment Statutes

A statute specifically excluding a willfully abandoning parent from participating in a deceased child's estate is undoubtedly a powerful and direct remedy to unfair distribution and it should be included in all jurisdictions' intestate provisions. This model statute should also be relatively noncontroversial.[96] In fashioning such a statute, five basic issues need to be addressed at the outset.

First, who are the parties? The apparent starting point is the legal relationship of a parent and child.[97] For the definitions of parent and child, an abandonment statute should use indefinite grammar ("any" or "a")[98] and should avoid limiting or qualifying adjectives (such as "natural" and "minor").[99] The primary focus of the statute should be on parental conduct, not on subcategories of a parent-child relationship.

---

92. U.P.C. § 2-114 (10th ed. 1991).

93. *Id.* § 2-114(a).

94. *Id.* § 2-114(b).

95. *Id.* § 2-114(c).

96. No negative votes were cast in passing Connecticut's statute. *See* sources cited *supra* note 81.

97. Since an abandonment statute is basically a forfeiture statute, a person must first qualify as an heir under the jurisdiction's intestate rules. Thus a primary determination of parent-child relationship has been made.

98. *E.g.*, N.C. GEN. STAT. § 31A-2 (1984).

99. *E.g.*, UNIFORM PROBATE CODE § 2-114(c) (10th ed. 1991) ("natural parent"); 20 PA. CONS. STAT. ANN. § 2106(b) (Supp. 1993) ("minor or dependent child").

Moreover, with respect to the child, the use of limiting adjectives may raise questions concerning the timing of the child's death. For example, if a statute is framed in terms of a minor child, with the abandoning parent's inheritance barred from the estate of the "minor child" or "such child," one implication is that the child's death must occur before the child reaches majority.[100] This result is counterproductive. The burden should be on the abandoning parent to change conduct; it should not be on the abandoned child to execute a will, and certainly not on an incapacitated adult child to do the impossible. From this perspective, New York's "whether or not such child dies before having attained the age of twenty-one years"[101] is clear and vastly preferable to Ohio's "minor child who subsequently dies intestate as a minor."[102]

Second, what conduct precludes a parent's inheritance? Willful abandonment of a child to whom a parent owes duties of support is an obvious standard.[103] Whether additional grounds are necessary or advisable (such as desertion or a parent failing or refusing to provide)[104] will most likely depend on the jurisdiction's statutes and case law precedent in the family law arena. A statutory length of time, such as one year, for an abandonment to work a forfeiture seems unnecessary and inappropriate.[105] The workhorse here should be an equitable standard of abandonment; the length of the non-

---

100. This seems especially so if "minor child" is used. *See, e.g.*, In re Estate of Teaschenko, 574 A.2d 649 (Pa. 1990) (interpreting "shall have no right . . . in the . . . estate of the minor or dependent child" as requiring that, in Pennsylvania, the decedent be a minor or dependent child). It seems less clear if "such child" is used. *See* CONN. GEN. STAT. ANN. § 45a-439(a)(1) (West Supp. 1993) ("in the estate of such child").

101. N.Y. EST. POWERS & TRUSTS LAW § 4-1.4 (McKinney 1981).

102. OHIO REV. CODE ANN. § 2105.10(B) (Anderson Supp. 1992).

103. Five of the six jurisdictions use abandonment (New York, North Carolina, Connecticut, Virginia and Ohio); only North Carolina and Virginia specifically use "willfully" in their statutes. Pennsylvania uses "willfully deserted." *See supra* notes 67-95 and accompanying text.

The determination as to what conduct actually constitutes abandonment is clearly fact specific, and beyond the scope of this Article. For focus and simplicity, our hypotheticals assumed the issue. The resolution of this factual inquiry inevitably will involve the drawing of lines that will vary among jurisdictions. Neither the factual nature of the inquiry nor the likely divergent determinations should be viewed as insurmountable obstacles.

104. *E.g.*, New York has alternate grounds for disqualifying a parent: "Failed or refused to provide for or has abandoned such child." N.Y. EST. POWERS & TRUSTS LAW § 4-14 (McKinney 1981). Commentary on the section states "The exact words, 'failed or refused to provide' carry, it would seem, the connotation of willfulness, and there would be no purpose in disqualifying a parent who tried but could not quite provide, either adequately or at all. . . . Failure to provide is just about self-explanatory. . . ." WEST'S MCKINNEY'S FORMS, ESTATES & SURROGATE PRACTICE § 8.14 (1982).

105. In defining "abandoned," Ohio uses a standard "of at least one year immediately prior" to the child's death. OHIO REV. CODE ANN. § 2105.10(A)(1) (Anderson Supp. 1992). Pennsylvania also uses a one year standard. 20 PA. CONS. STAT. ANN. § 2106(b) (Supp. 1993).

involvement is only one factor in determining whether or not abandonment has occurred.

Third, what action, if any, will rehabilitate an abandoning parent? As an initial matter, it is entirely appropriate for an intestate abandonment statute, based on equitable principles, to distinguish between abandoning parents who never return from those who do.[106] Resumption of the parental relationship and parental duties, if any, for a sustained period of time continuing until the death of the child seems to be an appropriate standard.

The question of determining an appropriate time frame, that is when the parent must return, involves two separate concerns. If the rehabilitative portion of the statute speaks in terms of a resumption of parental duties, one implication is that the parent must return while duties are in fact owed to the child, generally while the child is a minor.[107] This standard may be too narrow. The focus should be the quality of the returning parent's relationship to the child and the parent's discharge of duties to the child, if any.[108] The second concern involves the length of the parent's return before the child's death.[109] A parent's return (say after five years of abandonment) that is one week before the child's death seems insufficient. Thus, the standard should be as follows: the return of the abandoning parent to the parental relationship should be both continuous until the child's death and for a sustained period of time.

Fourth, what is the effect of the parent's abandonment on the distribution of intestate property and on the administration of the estate? Two methods for disposing of the intestate property come to mind. First, the property could be distributed as if the abandoning parent had predeceased the child.[110] This is

---

106. The two oldest statutes, North Carolina and New York, provide for this rehabilitation directly. Connecticut and Ohio may accomplish the same result indirectly by requiring the abandonment to be continuous until the child's death. Pennsylvania's statutory language is ambiguous on this point—a one year willful desertion may work a complete forfeiture, regardless of the resumption of the parental duties. Virginia is somewhat confusing since a parent's abandonment of a child that continues until the death of the child bars the parent's interest, unless the parent resumes the parental relationship and duties until the death of the child. One of the "until the death of the child" clauses should be deleted from the Virginia statute.

107. *E.g.*, VA. CODE ANN. § 64.1-16.3(B) (Michie Supp. 1993); N.Y. EST. POWERS & TRUSTS LAW § 4-1.4 (McKinney 1981). *See also supra* note 3.

108. "The resumption of the parental relationship with the child may presumably occur after the period of infancy has passed and the parent is no longer obliged to provide for the child (citing in re Lascelles' Estate, 68 N.Y.S. 2d 70 (1947)), but it must be clear that the parent has undertaken his parental duty to promote the growth and development of the child with reasonable diligence. . . ." Patrick J. Rohan & Samuel Hoffman, *Practice Commentary to N.Y. Est. Powers & Trusts Law* § 4-1.4, at 744-45 (McKinney 1981 & Supp. 1993).

109. North Carolina requires the parent's return to be for at least one year and for it to continue until the child's death. N.C. GEN. STAT. § 31A-2 (1984). New York and Virginia only require a parent's return to continue until the child's death. N.Y. EST. POWERS & TRUSTS LAW § 4-1.4(b) (McKinney 1981); VA. CODE ANN. § 64.1-16.3(B) (Michie Supp. 1993).

110. *See, e.g.*, N.Y. EST. POWERS & TRUSTS LAW § 4-1.4(b) (McKinney 1981) and OHIO

simple and straightforward. Thus, the non-abandoning, caring parent would inherit all in the majority of states that have the parents sharing equally.[111] This is as it should be. But in the states where parents and siblings (often including half-bloods) share equally, the issue is more difficult.[112] In this instance, the caring parent and the abandoning parent's two children from a new marriage (who are unknown to the decedent) may share the estate in thirds.[113] This distribution does not seem appropriate.

For these jurisdictions, an alternative is to extend the abandoning parent's exclusion to all those who claim through that parent.[114] This has a certain degree of appeal. After all, why should the unknown half-sister and half-brother participate in the estate? There are, however, two basic problems. First, this smacks of the common law doctrine of "corruption by blood," which has been generally repudiated by statute and constitution.[115] Second and more important, this automatic derivative exclusion is as offensive to our notions of fairness as the automatic inclusion of an abandoning parent. For example, the unknown half-sister and half-brother should not be in the same category as the caring half-sister. If the derivative exclusion method is used, it should not apply to those who can show the existence of an active and caring relationship with the child, which is independent of the abandoning parent.[116]

In addition to the actual distribution of property, an abandonment statute should also preclude that parent from serving as administrator and from participating in the process of selecting an administrator.[117]

Finally, the process for determining whether a parent has in fact abandoned a child should be considered. Of the six jurisdictions discussed, only Ohio includes within its statute a specific and detailed procedure for determining abandonment.[118] The remaining five apparently rely on the existing probate framework for adjudicating issues of heirship. There appears

---

REV. CODE ANN. § 2105.10(B) (Anderson Supp. 1992).

111. *See supra* note 7; but note that Texas provides that if only one parent survives, the brothers and sisters will then share. TEX. PROB. CODE ANN. § 38(a)(2) (West 1980).

112. *See supra* notes 8 and 9 and accompanying text.

113. *Id.* Illinois is alone in providing that if one parent is deceased, the surviving parent then receives a "double portion"; thus in Illinois, the caring parent would receive one-half and the two half-blood siblings would each receive one-fourth. 755 ILL. COMP. STAT. § 5/2-1(d) (1993).

114. *See, e.g.*, U.P.C. § 2-114(c) (10th ed. 1991).

115. *See* Reppy, *supra* note 53, at 244.

116. The degree of latitude advocated here may seem extraordinary in the context of intestate rules, but the situation itself is extraordinary. In making a determination as to the relationship, a court may draw upon factors similar to those used in wrongful death cases for distributing proceeds in proportion to the survivor's losses.

117. *E.g.*, N.C. GEN. STAT. § 31A-2 (1984) (abandoning parent loses "all right to administer the estate of the child").

118. *See supra* notes 87 and 89 and accompanying text.

to be no reason for special procedural rules regarding this question; therefore, whether additional safeguards should be in place is a local question.

V. Other Statutory and Judicial Strategies

Since (1) a functional interpretation of parent has been resisted, (2) *indignitas* as a legal theory is not well known, and (3) only a handful of states have specific abandonment statutes, the existence of other statutory approaches to distribution should be explored. In both hypotheticals, the goal is to have the property of the child go exclusively, or as much as possible, to the caring parent.[119] Therefore, is there a legal mechanism outside of heirship for the child to give his property at death to the caring parent? Conversely, is there a legal mechanism outside of heirship for the caring parent to claim the child's property at death? The answer to both questions is generally no, but statutes concerning disabled persons are making inroads. Two recent examples will be briefly explored since they offer additional evidence of a growing frustration with the inflexibility of the intestate scheme.

A. Illinois Conditional Gift and Custodial Claim Statutes

On January 1, 1989, a statute concerning discretionary distributions from the estate of a disabled person became effective in Illinois.[120] The provision represents a sweeping grant of authority to the court to authorize conditional gifts as the court deems "just and reasonable":

> The court may authorize and direct the guardian of the estate to make conditional gifts from the estate of a disabled person to any spouse, parent, brother or sister of the disabled person who dedicates himself or herself to the care of the disabled person by living with and personally caring for the disabled person for at least 3 years. It shall be presumed that the disabled person intends to make such conditional gifts.[121]

By definition, a disabled person is eighteen years or older and one who suffers from a mental or physical incapacity or disability.[122] The statute specifically limits donees to a class of defined relatives who perform certain prescribed acts of caring. The court may impose "conditions on the gift" as

---

119. This seems self-evident. *See* John H. Beckstrom, *Sociobiology and Intestate Wealth Transfers*, 76 NW. U. L. REV. 216 (1981) for a different and interesting genetic analysis as to why this is so.

120. 755 ILL. COMP. STAT. § 5/11a-18.1 (1993). Very little legislative history exists. H.B. 4116, 3 *Final Legis. Synopsis & Dig. 85th Ill. Gen. Assembly*, 2d Sess. (1988), 1932-34 (1989).

121. 755 ILL. COMP. STAT. § 5/11a-18.1(a) (1993).

122. 755 ILL. COMP. STAT. § 5/11a-2 (1993).

it "deems just and reasonable."[123] The gift may not be distributed to the donee until the disabled person's death.[124] The court may modify or revoke the gift at any time.[125]

At the same time that the Illinois Legislature enacted the conditional gift statute, Illinois also adopted a new provision entitling the caregiver to a statutory claim against the deceased disabled person's estate.[126] Just as in the conditional gift statute, the claim statute requires that the caregiver devote himself to caring for the disabled person. This statute, however, also permits a child to make a claim against the estate.[127] Unlike the conditional gift statute, however, this is a statutory entitlement to the caregiver. While prescribing that the amount of the claim depends upon the extent and nature of the disability[128] and is subject to the solvency of the estate, the statute lists stated minimums. It mandates $100,000 for a 100% disability, $75,000 if 75% disabled, $50,000 if 50% disabled and $25,000 if 25% disabled.[129] By providing concrete minimum amounts which are more than nominal values for the claims, as well as making these priority claims,[130] the legislative intent to reward caregivers seems clear.

In analyzing the Illinois conditional gift and the statutory custodial claim legislation, it is important to note the correctness of the legislative scheme: those who give important care to disabled persons have a claim of the highest priority. The provisions confirm that voluntary acts of responsibility and connection, and not mere bloodlines, should dictate the distribution of property. Although this legislation is a positive step, flaws exist in the legislation flowing primarily from the narrow band of participants—the statutes only apply to disabled adults and certain related caregivers. Again the quality of the caring relationship should be the critical inquiry, and not the age of the care-receiver or the blood or consanguinity connection of the caregiver. Applying these statutes in our hypotheticals, the mother of the disabled adult child will benefit from the Illinois statutes, but the father of the minor accident victim will not.

---

123. 755 ILL. COMP. STAT. § 5/11a-18.1(b) (1993).

124. *Id.* "A conditional gift shall not be distributed to the donee until the death of the disabled person."

125. *Id.*

126. 755 ILL. COMP. STAT. § 5/18-1.1 (1993). *See supra* note 120 for legislative history.

127. 755 ILL. COMP. STAT. § 5/18-1.1 (1993) ("Any spouse, parent, brother, sister, or child of a disabled person . . .") "Child" was recently added by amendment effective August 14, 1992. Ill P.A. 87-908 § 1 (1992).

128. 755 ILL. COMP. STAT. § 5/18-1.1 (1993). The statute also states: "The claim shall take into consideration the claimant's lost employment opportunities, lost lifestyle opportunities, and emotional distress experienced as a result of personally caring for the disabled person."

129. *Id.* The statute does not indicate how one determines the percentage of disability.

130. 755 ILL. COMP. STAT. § 5/18-10 (1993).

B. New York Guardian's Powers

Finding that the needs of incapacitated persons are "as diverse and complex as they are unique to the individual" and that the system lacked the "necessary flexibility" to meet those needs,[131] New York recently enacted comprehensive legislation concerning the appointment and powers of a guardian for an incapacitated person.[132] Effective April 1993, New York joins a minority of jurisdictions[133] that have legislation specifically permitting a judge to authorize transfers of the incapacitated person's property to another "on the ground that the incapacitated person would have made the transfer if he or she had the capacity to act."[134] The transfer may be in any form other than a will or codicil.[135] Therefore, transfers by way of outright gifts as well as by revocable and irrevocable trusts are now statutorily authorized.[136] In approving a transfer petition, a New York court must consider the capacity and wishes of the person, the nature and duration of the disability, the financial needs of the person, any tax savings, whether the donees are the "natural objects of bounty of the incapacitated person," whether the transfers are "consistent with any known testamentary plan or pattern of gifts," and finally "such other factors as the court deems relevant."[137]

In order to authorize the transfer, the judge must make three findings by clear and convincing evidence.[138] First, the judge must find that the person lacks the requisite capacity to perform the acts and is unlikely to regain such capacity "within a reasonable period of time," or that the person does have the requisite capacity and consents to the transfer.[139] Second, the judge must find that "a competent, reasonable individual . . . would be likely to perform the act . . . under the same circumstances."[140] Finally, the judge must find that the incapacitated person has not in the past manifested a contrary intention, or if he has, that he or she "would be likely to have changed such intention under the circumstances."[141]

The focus of the New York legislation is on what a reasonable person would do under the circumstances,[142] and the mechanism is judicial flexi-

---

131. N.Y. MENTAL HYG. LAW § 81.01 (McKinney Supp. 1993).

132. N.Y. MENTAL HYG. LAW § 81.01-.42 (McKinney Supp. 1993).

133. Other states include Massachusetts (MASS. GEN. L. ch. 201, § 38 (Supp. 1993)), Pennsylvania (20 PA. CONS. STAT. ANN. § 5536(b) (Supp. 1993)), California (CAL. PROB. CODE § 2580 (West 1993)).

134. N.Y. MENTAL HYG. LAW § 81.21(a) (McKinney Supp. 1993).

135. *Id.*

136. *Id.* § 81.21(a)(1) and (6).

137. *Id.* § 81.21(d).

138. *Id.* § 81.21(e).

139. *Id.* § 81.21(e)(1).

140. *Id.* § 81.21(e)(2).

141. *Id.* § 81.21(e)(3).

142. "Most particularly, the court should consider whether a competent reasonable person

bility to particularize the disposition of property.[143] It is comprehensive legislation that has the correct emphasis. When coupled with the New York abandonment statute[144] and applied to both hypotheticals, this legislation affords the greatest flexibility and protection to the caring parent.

C. Judicial Doctrine of Substituted Judgment

The Illinois gift and claim statutes and the New York guardian legislation can be seen as legislative manifestations of the judicial doctrine of substituted judgment.[145] This doctrine is traced to the 1816 case of *Ex parte Whitbread*, where Lord Eldon allowed a petition by the niece of an incompetent for a distribution from surplus income stating that "the Court, looking at what it is likely the Lunatic himself would do, if he were in a capacity to act, will make some provision. . . ."[146]

Without having special legislation,[147] some courts use this subjective doctrine today as the basis for making inter vivos distributions from the incapacitated person's property.[148] In doing so, courts have considered four

---

in the position of the incapacitated person would be likely to perform the act or acts under the same circumstances." Law Revision Commission, *Comments to N.Y. Mental Hyg. Law* § 81.21 (McKinney Supp. 1993).

143. *Id.* "This section sets forth the powers that the court may authorize. . . . The list is intended to be illustrative rather than exclusive."

144. *See supra* notes 74-77 and accompanying text.

145. "This section gives statutory recognition to the common law doctrine of substituted judgment recognized by the courts of this state and other jurisdictions." Law Revision Commission, *supra* note 142.

146. 2 Meriv. 99, 100, 35 Eng. Rep. 878, 879 (Ch. 1816). *See* William G. Thompson and Richard W. Hale, *The Surplus Income of a Lunatic*, 8 HARV. L. REV. 472 (1895).

147. All jurisdictions provide a statutory mechanism for handling an incapacitated person's financial affairs. Generally, and subject to court supervision, the guardian is under a duty to use the estate for the support of the incapacitated person and his or her dependents, or for other purposes as the court deems for the ward's best interest. SAMUEL JAN BRAKEL ET AL., THE MENTALLY DISABLED AND THE LAW 395-404 (3d ed. 1985); LEGAL COUNSEL FOR THE ELDERLY, DECISION-MAKING, INCAPACITY AND THE ELDERLY: A PROTECTIVE SERVICES MANUAL, CH. 6 (1987); JOHN J. REGAN, TAX, ESTATE AND FINANCIAL PLANNING FOR THE ELDERLY, ch. 16 (rev. ed. 1990).

148. The leading case adopting the substituted judgment doctrine for discretionary distributions in the United States is *In re* Guardianship of Christianson, 248 Cal. App. 2d 398, 56 Cal. Rptr. 505 (1967). California has since codified the doctrine. *See* CAL. PROB. CODE § 2580 (West 1991 & Supp. 1993). *See* Michael P. Kane, Comment, *The Application of the Substitution of Judgment Doctrine in Planning an Incompetent's Estate*, 16 VILL. L. REV. 132 (1970). *But see In re* Berger, 520 N.E.2d 690, 707 (Ill. App. Ct. 1987) ("Some jurisdictions authorize making allowances out of an incompetent's estate for the benefit of relatives on the basis of general application of this doctrine. . . . This doctrine has been neither rejected nor adopted by Illinois."); and the dissent by Justice Rizzi: "Although neither the Illinois Probate Act nor the Illinois Probate Act of 1975 has a provision which specifically concerns substituted judgment, I believe that the provisions of these Acts are . . . broad enough to encompass that concept." *Id.* at 712.

factors, namely: permanence of condition, needs of the disabled person, devolution of the property and donative intent.[149] These factors are among those generally included in the New York guardian legislation[150] and presumably operating *de facto* in the Illinois statutes.[151]

In the context of our hypotheticals, the doctrine of substituted judgment (found in the New York and Illinois acts) as currently developed does not apply to the teenage accident victim but could apply to the disabled adult child. Whether a particular court would apply the doctrine may depend on the fourth factor, donative intent. Since a child generally lacks capacity to make gifts of property, subjective donative intent has not been established by a tradition or a pattern of gift giving. For some courts, this may preclude the application of the doctrine; other courts presumably would surmise a probable donative intent on the facts and circumstances.[152] Nevertheless, the application of the substituted judgment doctrine does not mandate a particular result. A court must resolve the conflict raised by the third and fourth factors, that is, between a distribution based on bloodline status (devolution of the property) and a distribution based on acts (donative intent). Given the underlying rationale of the doctrine (to do what this disabled person would do if able), it stretches the imagination to think a court would find that an abandoned child would treat an unknown abandoning parent the same as a caring parent.

Even if a court applies the doctrine, judicial limits exist on the court's ability to make financial decisions.[153] The substituted judgment doctrine in financial matters, as developed by the courts, includes the power to make corpus distributions as well as income distributions,[154] to allow for the

---

For an excellent discussion concerning the doctrine of substituted judgment and its deployment in the health care informed consent arena, *see* Louise Harmon, *Falling Off the Vine: Legal Fictions and the Doctrine of Substituted Judgment*, 100 YALE L.J. 1 (1990).

149. *See, e.g., In re* Guardianship of Christianson, *supra* note 148.

150. N.Y. MENTAL HYG. LAW § 81.21(d) (McKinney Supp. 1993).

151. The Illinois conditional gift statute seems to anticipate the donative intent concern by stating: "It shall be presumed that the disabled person intends to make such conditional gifts." 755 ILL. COMP. STAT. § 5/11a-18.1(a) (1993).

152. *See, e.g., In re* Brennan C. Daly, 536 N.Y.S. 2d 393 (1988), where the Surrogate's court did authorize on a one year trial basis the making of annual exclusion gifts from the guardianship estate of an eleven-year-old brain damaged child to his siblings from the estate's excess income. The court indicated subjective intent is not required here especially as this would place a person disabled at birth at an unfair disadvantage: "In this day and in these circumstances, it would be inappropriate to cling in dogmatic fashion to rules which are incapable of satisfaction. Rather, the court in pursuit of its equitable powers is called upon to do justice." *Id.* at 395.

153. The substituted judgment doctrine in financial matters is separate and to be distinguished from the substituted judgment doctrine in personal care matters, such as health care decisions. *See, e.g.*, Cruzan v. Director, Missouri Dept. of Health, 497 U.S. 261 (1990). *See also* Harmon, *supra* note 148.

154. "If the quoted language was intended to suggest that the principle of substitution of judgment . . . can have no application to a disbursement from principal, it is not an acceptable statement of the Delaware law. I conclude that the substitution of judgment doctrine is not so

making of inter vivos gifts (generally for tax savings purposes)[155] and to provide for persons outside of the traditional family.[156] It has not been extended by the courts to the making of a will preferring one person over another. Until the eve of the new New York guardian legislation, there were no reported cases supporting a similar but non-testamentary arrangement, such as a inter vivos trust containing deathtime distributions differing from intestacy.[157] Despite its efficacy, this judicial doctrine has not evolved to include deathtime distributions in most jurisdictions in the absence of strong legislative support.[158] In those jurisdictions without other compensating judicial or legislative remedies, the doctrine is helpful and should not be ignored, but it is an incomplete remedy. The doctrine is not universally applied, and its narrow scope of donors (incapacitated persons) and transfers (inter vivos gifts) underscores its limitations.

VI. CONCLUSION

The tragic problem of parental abandonment of a child and the abandoning parent's subsequent inheritance from the child may seem largely anecdotal and not highly important to the legal system. Marginalizing the fact pattern misses the mark, however, as the proper target is the perceived fairness of the legal system. The intestate system developed centuries ago when the concerns expressed here did not exist. The system cannot be ignored, but the system properly viewed provides its own solutions. First, courts can perform their institutional duty to declare the ever-evolving common law by interpreting

---

restricted. Rather, the fact that a disbursement of principal is involved in the request only requires the court to move with greater caution in exercising its discretion." *In re* DuPont, 194 A.2d 309, 317 (Del. 1963).

155. *Id.* at 317 (authorizing a gift of $36,000,000 and payment of $21,000,000 gift tax from an incompetent's estate, for a total depletion of $57,000,000). *See also In re* Carson, 241 N.Y.S.2d 288 (1962); *In re* Kenan, 138 S.E.2d 547 (N.C. 1964).

156. *E.g.*, *In re* Heeney, 2 Barb. Ch. 326 (N.Y. Ch. 1847) the court permitted the continuation of a gift program to three elderly friends of "the same allowance which Mr. Heeney was in the habit of making to them." *See also In re* Brice, 8 N.W.2d 576 (Iowa 1943) (grant to a nephew).

157. The Surrogate's Court for Kings County approved the creation of a trust by a conservator, stating: "At the outset, it is observed that under the existing laws of this state, no statute exists expressly empowering the court to authorize the creation of trusts on behalf of a person under a disability. However, effective April 1, 1993, the courts will have the statutory authority to create trusts and sanction other types of transfers on behalf of these persons. (L. 1992, ch. 698, § 81.21). Until such date, the judicial doctrine of substituted judgment provides the governing authority for assessing the propriety of a proposed transfer for the purpose of providing for the needs of one other than the ward/transferor." *In re* Bessie H. Grabow, 591 N.Y.S.2d 754, 756 (Nov. 12, 1992).

158. *See In re* Estate of Anderson, 671 P.2d 165, 169 (Utah 1983) ("Read in harmony, these sections specifically exclude from the power of the court all dispositions made by will, because a will is ambulatory and does not speak until death.").

"parent" functionally when one claims an inheritance from a child. Similarly, in contexts involving guardianships, courts should use and develop the substituted judgment doctrine in a manner that favors a caring parent over an abandoning parent during the child's lifetime as well as at the child's death. Second, courts could recognize the role of the ecclesiastical courts in the development of the common law and invoke the equitable doctrine of *indignitas* to work a forfeiture or, alternatively, to assist in its functional definition of parent. Third, and most concretely, legislatures could enact abandonment statutes directly into the intestate schemes to reflect societal wishes. They also could enact legislation similar to Illinois' conditional gift statute and custodial claim statute or New York's Article 81, aimed at rewarding positive conduct.

The root of the legal problem is intestacy's historic link to feudal life and to property rights based on inflexible bloodlines. It is time for the legal system to recognize that in certain compelling circumstances, positive acts of responsibility should prevail over willful displays of irresponsibility.

EPCRA'S COLLISION WITH FEDERALISM

NICHOLAS J. JOHNSON*

INTRODUCTION

The Emergency Planning and Community Right to Know Act[1] (EPCRA) has noble goals. It permits local governments and communities to obtain information about potential hazardous substances threats and requires communities to develop plans for addressing hazardous material emergencies. I will suggest here that EPCRA also assaults core principles of federalism protected by the Tenth Amendment and the scheme of limited federal powers embodied in the Constitution.[2]

I will argue that EPCRA ranges so far outside the boundaries of cooperative federalism that it may be impossible to fit its entire agenda within that construct. I then will examine the impact of the statute on aspects of the state political process. Finally, I will suggest that, if sustained as a model, EPCRA may be the gust that extinguishes any hope of limiting federal power through the Tenth Amendment.

I. THE CORE BREACH

EPCRA generates the same breach of federalism that recently prompted the United States Supreme Court to strike down the take title provisions of the Low-Level Radioactive Waste Policy Amendments Act of 1985, ("Radioactive Waste Act").[3] In *New York v. United States*,[4] the Court struck down the

---

* Associate Professor, Fordham University School of Law. B.S.B.A. *Magna Cum Laude*, 1981, West Virginia University; J.D., 1984, Harvard Law School. I would like to thank Joel Burcat, my former colleague at Kirkpatrick & Lockhart, for the many conversations we had on this subject and for sharing his files chronicling Pennsylvania's response to EPCRA. This article benefitted from the comments of Robert Kaczorowski, Henry McGee, John Pittinger and Marc Arkin. The article began as a short paper for the Independence Institute. Adam Babich, David Kopel and Barry Hartman provided helpful comments on that paper.

1. Title III of the Superfund Amendments and Reauthorization Act (SARA), ch. 116, §§ 1-3, 100 Stat. 1729-58 (1986) (current version at 42 U.S.C. §§ 11000-11050 (1992)). Briefly stated, EPCRA orders state creation of an Emergency Response Commission and Emergency Planning Committees. Through these entities it requires the creation of emergency planning districts and local emergency response plans. It defines regulated substances and entities subject to record keeping and reporting requirements and establishes a system of enforcement penalties. For a detailed description of EPCRA, see Joel R. Burcat & Arthur K. Hoffman, *The Emergency Planning and Community Right-to-Know Act of 1986: An Explanation of Title III of SARA*, 18 ENVIRONMENTAL LAW REPORTER, NEWS & ANALYSIS 10007 (1988). *See also infra* note 15.

2. "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. CONST. amend. X. Article I, Section 8, gives Congress 18 enumerated powers.

3. Act of 1985, ch. 23, § 102, 99 Stat. 1942 (1986) (current version at 42 U.S.C. § 2021 et. seq (1993)).

4. 112 S. Ct. 2408 (1992). The Court asserts that *New York* is distinct from the unsteady

portion of the Radioactive Waste Act that forced states either to provide disposal sites for low level radioactive waste, or take title to the waste generated within their borders. The fatal step of the Radioactive Waste Act was its flat command that states regulate low level radioactive waste.[5]

In the strongest terms, the Court declared that this direct command violated core principles of federalism protected by the Tenth Amendment:

> Congress may not simply 'commandeer the legislative process of the states by directly compelling the states to enact and enforce a federal regulatory program.'[6]
>
> . . . .
>
> [E]ven where Congress has the authority under the Constitution to pass laws requiring or prohibiting certain acts, it lacks the power directly to compel the States to require or prohibit those acts.[7]
>
> . . . .
>
> Whatever the outer limits of [state] sovereignty may be, one thing is clear: The Federal Government may not compel the states to enact or administer a federal regulatory program.[8]

EPCRA generates precisely the type of violation that compelled the Court to strike down the take title provisions of the Radioactive Waste Act. Eschewing traditional incentives for eliciting state regulation,[9] EPCRA issues a flat command: "The Governor of each state shall appoint a State emergency response commission."[10] The commission is directed to implement EPCRA through a variety of congressionally designed powers and duties.[11] EPCRA provides only one option for a governor who objects to this congressional

---

path of Tenth Amendment cases involving the application of general federal regulations to core state activities. *See* National League of Cities v. Usery, 426 U.S. 833 (1976); Garcia v. San Antonio Metropolitan Transit Authority, 469 U.S. 528 (1985). *New York* examines when "Congress may use the states as implements of regulation." 112 S. Ct. 2420. This question seems subject to less controversy: "Congress may not simply 'commandeer the legislative process of the States by directly compelling them to enact and enforce a federal regulatory program.'" *Id. But see infra* text accompanying notes 50-54 (arguing that the distinction between *New York* and the *Garcia* string of cases is not as clear as the Court has suggested).

5. The Constitution does not permit Congress to compel states to create disposal sites. *Id.* at 2428.

6. *Id.* at 2420 (citing Hodel v. Virginia Surface Mining & Reclauation Ass'n, Inc., 452 U.S. 288 (1981)).

7. *Id.* at 2423.

8. *Id.* at 2435.

9. The traditional incentives include punishing recalcitrance by withholding related funding or giving states the choice of regulating or having Congress regulate directly. *See New York*, 112 S. Ct. at 2423. Strictly speaking, it is this latter option the Court calls "a program of cooperative federalism." *Id.* at 2424.

10. EPCRA § 301, 42 U.S.C. § 11001 (1992).

11. *See infra* note 83 (explaining powers and duties that constitute regulation).

order: "If the Governor of any State does not designate a State emergency response commission within such period, the Governor shall operate as the State emergency response commission until the Governor makes such designation."[12]

Just as the Radioactive Waste Act gave New York no choice but to regulate low level radioactive waste, EPCRA gives states no choice but to adopt Congress' regulatory agenda. Indeed, EPCRA's command is more offensive. In *New York*, there was at least a technical, although non-curative, alternative of taking title to radioactive waste.[13] EPCRA fails to provide even that dubious option. A governor's alternative to creating an emergency response commission to implement the statute is personally to perform the functions of the commission he refuses to create. The state still is required to implement EPCRA.[14]

---

12. EPCRA § 301, 42 U.S.C. § 11001.

13. This alternative underscored rather than validated the congressional coercion. *See* New York v. United States, 112 S. Ct. 2408, 2428 (1992).

14. The broad order to adopt the federal regulatory scheme (EPCRA § 301) is the king root of EPCRA's breach. But various details of implementation contain similar offensive commands. These are clustered primarily in sub-chapter I (§§ 301-05). As described below, sub-chapters II and III are less offensive and, if deemed severable from sub-chapter I, with slight modification might survive a scrupulous Tenth Amendment critique. Whether the statute could function without the offensive provisions from sub-chapter I is questionable. A detailed analysis of that issue is beyond the aim of this Article.

Sub-Chapter I of EPCRA is entitled, "Emergency Planning and Notification." Section 301(b) requires the commission to establish jurisdictional boundaries for "emergency planning areas." Section 301(c) describes in minute detail the membership of the local emergency planning committees that the commission (or the governor) is ordered to create. The same section mandates the internal rules by which the local planning committees shall function:

> Such rules shall include provisions for public notification of committee activities, public meetings to discuss the emergency plan, public comments, response to such comments by the committee, and distribution of the emergency plan. The local emergency planning committee shall establish procedures for receiving and processing requests from the public for information under Section 324.

EPCRA § 301(c), 42 U.S.C. § 110001.

Section 302(d) requires the commission (or the Governor) to report to the administrator of EPA the list of regulated facilities.

Section 303(a) orders the local committees to prepare an "emergency plan" and review it on a yearly basis. Section 303(b) orders each committee to "[e]valuate the need for resources necessary to develop, implement, and exercise the emergency plan."

Section 303(c) contains nine subparts that describe what the emergency plan "shall include." Among these are: "methods and procedures to be followed by . . . local emergency and medical personnel to respond to any release of such substances . . . [and] [t]raining programs, including schedules for training of local emergency response and medical personnel." *See* EPCRA §§303(c)(2), (8). This order, which establishes training programs and develops procedures controlling the actions of local fire departments and rescue teams, is arguably the next most offensive order to regulate. *See also infra* subpart II(B) (arguing that fire department activities are the archetypical core state activities the Court earlier considered immune from federal interference). Section 303(f) adds further details, directing the EPA National Response Team to

II. Beyond the Limits of Cooperative Federalism

A. The Necessity of Choice

EPCRA clashes violently with the cases and principles that define the limits of "cooperative federalism." In *Hodel v. Virginia Surface Mining Reclamation Ass'n*, the Court characterized cooperative federalism as a valid exercise of congressional power in which states may choose either to implement federal regulations, or suffer direct federal implementation.[15] The absence of a flat command to regulate was controlling in *Hodel*: "There can be no suggestion that the Act commandeers the legislative processes of the States by directly compelling them to enact and enforce a federal regulatory program."[16] The federal government would shoulder the full regulatory burden if a state chose not to implement the program. That choice, which is

---

publish guidance documents for preparation of emergency plans. While such guidance documents generally are binding on EPA field offices (*see, e.g.*, EPCRA § 313 Penalty Assessment Guidance), it is not clear whether they purport to bind local planning committees. Even if the details of guidance documents are viewed only as suggestions, that does not diminish the violation resulting from the general command that the committee develop procedures controlling local fire departments and emergency medical personnel.

Section 303(c) also requires the emergency plan to identify emergency transportation routes; identify adjacent facilities that might contribute risk to a hazardous materials emergency; designate and empower a community emergency coordinator who will help implement the emergency plan; designate procedures for providing notice of a release to the public; describe available emergency equipment and the individuals responsible for it; develop evacuation plans; and develop schedules for exercising the emergency plan.

Section 303(e) creates obligations between the committees and the commission: "[each committee] shall submit a copy of the plan to the commission or the governor."

Sub-Chapter II of EPCRA (§§ 311-13) governs reporting requirements and primarily compels regulated facilities (*e.g.*, those using threshold amounts of listed hazardous substances) to provide federal and state officials with information about hazardous substances used in the production process. Except for provisions in sections 312(e)(3)(A) and (B), requiring commissions and committees to make information provided by regulated facilities publicly available, sub-chapter II is free from obvious commands to regulate.

Sub-chapter III (§§ 321-30) contains EPCRA's enforcement provisions, which are a part of the analysis of subpart II(C) of this Article. Section 324 fits the coerced regulation mold. It provides detailed instructions governing the public availability of the emergency plan and other documents. It also requires public notice of their availability.

These numerous instructions are characteristic of the detail that a responsible principle would provide to a marginally competent agent. They underscore EPCRA's conscription of states into the "federal government's organizational chart". *New York*, 112 S. Ct. at 2434.

15. 452 U.S. 264 (1981). The Court upheld the Surface Mining Control and Reclamation Act of 1977 against a Tenth Amendment challenge. It may be imprecise to call state regulation in the face of the Surface Mining Act cooperative. Choosing to regulate against the alternative of completely losing control over what had been considered a core state prerogative seems less than cooperative.

16. *Hodel*, 452 U.S. at 288.

pivotal to the validity of congressional efforts to elicit state regulation,[17] is absent from EPCRA.

Although *District of Columbia v. Train*[18] sliced the question more thinly,[19] the states' choice to regulate was still key. At issue was the validity of Clean Air Act regulations requiring states to enforce federal emissions standards for vehicles they registered. The D.C. Circuit distinguished between requiring states to regulate and requiring states to enforce federal standards if they chose to regulate.[20] This distinction presages the Supreme Court's decision in *FERC v. Mississippi*,[21] which permits even greater federal intrusion into state decision-making, but does not endorse the direct compulsion of the EPCRA model.

In *FERC*,[22] the Court permitted the imposition of federal PURPA[23] standards on state utility commissions, reasoning that Congress had the power to preempt the field and that states could choose not to regulate. Central to the outcome was the Court's conclusion that "[t]here is nothing in PURPA directly compelling the states to enact a legislative program."[24] The Court found this absence of compulsion in the states' choice of abandoning the field of regulation altogether.[25]

In a powerful dissent, Justice O'Connor argued that "[t]he Court's 'choice' is an absurdity, for if its analysis is sound, the Constitution no longer limits federal regulation of state governments. . . . Congress could dictate the agendas and meeting places of state legislatures, because unwilling States would remain free to abolish their legislative bodies."[26]

---

17. "By either of these two methods [making state regulation the *quid pro quo* for federal funding or giving states the choice to regulate or have Congress regulate], as by any other permissible method of encouraging a State to conform to federal policy choices, the residents of the State retain the ultimate decision as to whether or not the State will comply." New York v. United States, 112 S. Ct. 2408, 2424 (1992).

18. 521 F.2d 971 (D.C. Cir. 1975).

19. *Train* actually permitted what the Court tried to characterize as a de minimus federal order requiring state regulation. *See infra* text accompanying notes 94-100 (discussing *Train* as a model for diminishing the impact of *New York*).

20. *Train*, 521 F.2d at 987.

21. 456 U.S. 742 (1982).

22. *FERC* involved a challenge to the Public Utility Regulatory Policies Act of 1978 (PURPA), the aim of which was to promote conservation and reduce electric producers' use of oil and natural gas. PURPA required states to enforce standards promulgated by FERC; directed states to consider specific rate-making standards; and imposed certain procedures on state utility commissions.

23. Public Utility Regulatory Policies Act of 1978 (PURPA), ch. 59, § 115(a), 106 Stat. 2803 (1992) (current version at 15 U.S.C. §§ 3201 et. seq. (1993); ch. 12, § 201, 92 Stat. 3144 (1978); § 643(b), 94 Stat. 770 (1980) (current version at 16 U.S.C. §§ 824(a)-(b)).

24. *Id.* at 765.

25. *Id.* at 766.

26. In *FERC*, Justice O'Connor's dissent emphasized the distinction between compulsion and cooperative federalism. *Id.* at 781-82. Citing *Hodel*, she described the "program of

Justice O'Connor's criticism of the "choice" the majority discovered in *FERC* tells volumes about EPCRA.[27] EPCRA provides no "choice." The closest states could come to the *FERC* option of "abandoning the field" would be to extinguish the office of governor.[28]

There have been a variety of signals pre-*New York* that the Commerce Clause, while bordering on omnipotence, does not permit Congress to commandeer the state legislative process.[29] In *EPA v. Brown*,[30] the EPA administrator admitted as much.[31] Although the Court previously has flirted

---

cooperative federalism validated in that case" (one where a state may choose to regulate in accord with federal instructions or not to regulate at all). Unconvinced that abandoning the field of regulation was a true "choice," O'Connor argued *FERC* did not present a case of cooperative federalism as understood in *Hodel*. *Id.* at 783.

27. *See also* South Carolina v. Baker, 485 U.S. 505 (1988). In *Baker*, the Court reviewed provisions of the Tax Equity and Fiscal Responsibility Act of 1982, which allowed an exclusion for interest on state issued bonds only for "registered state bonds" and eliminated the exclusion for "bearer" state bonds. The Court concluded that the statute did not commandeer the state political process, pointing out that the challenged section, "regulates state activities; it does not as did the statute in *FERC*, seek to control or influence the manner in which States regulate private parties." *Id.* at 514.

See also Hodel v. Virginia Surface Mining Reclamation Ass'n, Inc., 452 U.S. 264 (1981). In *Hodel*, the statute required a federal agency to administer regulations. The federal program was to remain in effect until the state implemented a substitute. *Id.* at 269-70.

28. Indeed, where the governor's obligations would shift by state law to a variety of successors, the state's "choice" would be to eliminate a good portion of its executive branch.

29. *See, e.g.*, Maryland v. EPA, 530 F.2d 215, 224 (4th Cir. 1975). "In a nutshell, the EPA has directed Maryland and her legislature to legislate under pain of civil and criminal penalties. . . . If there is any attribute of sovereignty left to the states it is the right of their legislatures to pass or not to pass laws. . . ." *Id.* at 225. "Not far afield is the rejection by the Philadelphia Convention of Charles Pinkney's constitutional plan, which would have enabled Congress to 'revise,' 'negative,' or 'annul' the laws of a state." *Id.*

30. 431 U.S. 99 (1977).

31. *Brown* was the culmination of several state challenges to regulations under the Clean Air Act (CAA), 42 U.S.C. §§ 1857 (1977) (current version at 42 U.S.C. § 7401 et. seq. (1993)) which required states that had not developed approved State Implementation Plans (SIP) to issue regulations enforcing a federal implementation plan. The CAA authorized the administrator to develop a federal implementation plan in the absence of an approved SIP.

EPA attempted to order states to (1) develop inspection and maintenance programs and submit to the administrator state regulations by which the program would be run; (2) develop retrofit programs for older vehicles; (3) designate and enforce preferential bus and car-pool lanes; (4) develop a program to monitor emissions; and (5) adopt certain other programs which varied by state. *Brown*, 431 U.S. at 101.

The case was streamlined by EPA's withdrawal of its request for review of certain issues. EPA conceded that its regulations required modification in order to remove requirements that states "submit legally adopted regulations." *Id.* EPA also contended that its regulations did not attempt to force states to adopt laws; apparently conceding what is clear in *New York* - that such direct commands from the federal to state governments are impermissible. The Court vacated the lower court cases because EPA conceded the error of its attempts to compel states either to legislate or to promulgate regulations. "The federal parties' position now appears to be that, while the challenged transportation plans do not require the enactment of legislation, they do contain, and

with permitting Congress to commandeer state governments,[32] *New York* makes clear that temptation, for the moment, has passed.[33]

EPCRA is in the same analytical channel as *Hodel*, *FERC* and *New York*. Its *raison d'etre* is to order state regulation of users and producers of hazardous materials.[34] Absent the choice to regulate, EPCRA is vulnerable to a facial constitutional attack.

B. Congress' Questionable Power to Implement EPCRA Directly

It is also difficult to fit EPCRA within the classic cooperative federalism model because the assertion and existence of commerce power to implement EPCRA directly is cloudy. Congress has not explicitly asserted Commerce Clause authority over the activity enveloped by EPCRA,[35] and the statute contains no mechanism for direct federal implementation. Although there have been suggestions that latent commerce power to regulate[36] might establish the choice component of cooperative federalism, the *New York* decision does not acknowledge that possibility. Indeed, a latent commerce power analysis would

---

must be modified to eliminate certain requirements that states promulgate regulations." *Id.* at 103.

In the vacated cases the administrator declared openly that pure necessity compelled an interpretation of the CAA permitting him to force states to enact legislation and promulgate regulations. A similar perceived necessity may also drive EPCRA. *See infra* subpart IV(A) of this Article.

32. *FERC* suggested that Congress' ability to commandeer the state legislative process was an open question: "While this Court has never explicitly sanctioned a federal command to states to promulgate and enforce laws and regulations, there are instances where the Court has upheld federal statutory structures that in effect directed state decision makers to take or to refrain from taking certain actions." *FERC*, 456 U.S. at 761-62 (citing *Brown*, 431 U.S. 99). The Court concluded that "whatever all this may bode for the future" it was unnecessary to resolve the question in the context of the PURPA dispute. *Id.* at 764.

In *Baker*, the Court acknowledged that *FERC* left open whether the Tenth Amendment limits Congress' ability to compel states to regulate, but questioned the extent to which this question survives Garcia v. San Antonio Metropolitan Transit Authority, 469 U.S. 528 (1985). As we see in *New York*, the Court now treats *Garcia* and its progeny as a separate line of analysis, but makes clear that Congress cannot commandeer the state legislative process. New York v. United States, 112 S. Ct. 2408, 2420 (1992).

33. The *Garcia* dissenters who predicted a shift back toward a substantive Tenth Amendment seem to guide the majority at present.

34. Commanding the governor to legislate seems more offensive than commanding legislatures to do so. Forcing states to administer the program also may be an improper delegation of federal executive branch enforcement authority. This is a more difficult argument, and such delegations (under traditional cooperative federalism model - i.e., giving states a true option) seem common. *See, e.g.*, EPA v. Brown, 431 U.S 99 (1977), which lists a variety of delegations of enforcement authority under the CAA.

35. EPCRA does not contain an explicit congressional assertion of Commerce Clause power, nor does it create a structure through which Congress could implement the statute directly.

36. The majority in *FERC* intimates that Congress' latent option, preempting the field of utility regulation entirely, was sufficient to validate the "federal command". *FERC*, 456 U.S. at 764.

seem to consume the existing cooperative federalism standard and dissolve the line established in *New York* through the argument that Congress *could have* created a direct enforcement option in a statute that issues a flat command to regulate.[37]

More importantly, it is not clear that the current Court would permit Congress to do directly all of the things necessary for EPCRA to function.[38] Direct congressional implementation of EPCRA would mean a federal bureaucratic structure duplicating *inter alia* the functions of local fire departments.[39] As the Court stated in *National League of Cities v. Usery*,[40] and as Justice Powell noted again in his dissent in *Garcia v. San Antonio Metropolitan Transit Authority*,[41] local fire and police services are the

---

37. Congress' latent ability to regulate low level radioactive waste did not save the Radioactive Waste Act. In dissent, Justice White stated, "I do not read [the majority's] opinion to preclude Congress from adopting a similar measure [directly] through its powers under the Spending or Commerce Clauses." New York v. United States, 112 S. Ct. 2408, 2445 (1992) (White, J., dissenting).

38. Given the relationships and duties EPCRA creates, independent federal implementation would require mobilization of an army of federal employees running parallel to existing state and local agents. *See, e.g.*, EPCRA §§ 301-03 (creating relationships between regulated entities and local health workers, fire departments, state regulatory agencies, which include a broad range of local players on emergency planning committees, and others. As a practical matter, EPCRA is probably impossible for Congress to implement using only federal resources. *Cf.* Maryland v. EPA, 530 F.2d 215, 227 (4th Cir. 1975) (describing the "[h]ordes of federal employees that would be required to enforce the Maryland implementation plan."); District of Columbia v. Train, 521 F.2d 971, 981 n.17 ("If we left it all to the Federal Government, we would have about everyone on the payroll of the United States.").

39. *See, e.g.*, EPCRA §§ 303(c)(2), (8). These provisions requiring development of "training programs" and "methods and procedures" governing the activities of local emergency (fire departments) and medical personnel are central to EPCRA's goal of uniform hazardous materials emergency response. *See also supra* note 14 (describing the types of local government action prescribed by EPCRA).

40. 426 U.S. 833 (1976).

41. 469 U.S. 528 (1985). In Brown v. EPA, 521 F.2d 827 (9th Cir. 1975), the court concluded: "To make governance indistinguishable from commerce for purpose of the Commerce power . . . would reduce the states to puppets of a ventriloquist Congress." *Id.* at 839. By raising the distinction between commerce and state power to regulate commerce, the court added a useful gloss to the analysis that is not present in *New York*. The distinction suggests that Congress may regulate "X" without being permitted to order states to regulate "X". This provides a different basis for protecting states' legislative prerogative than merely saying that ability to legislate is at the core of state sovereignty. It permits us to say, that the Commerce Clause does not extend to state regulation of commerce, because that regulation is not itself "commerce." This truly distinguishes *New York* from *National League* and *Garcia*. Absent this distinction, the assertion that the state legislative function is sacrocsant, really is only the strongest rendition of the *National League* (protection of traditional state functions) argument. *But see* FERC v. Mississippi, 456 U.S. 742, 764 (1982), noting that, "A court may invalidate legislation enacted under the Commerce Clause only if it is clear that there is no rational basis for a congressional finding that the regulated activity *affects* interstate commerce, or that there is no reasonable connection between the regulatory means selected and the asserted ends." *See also* New York v. United States, 112 S. Ct. 2408, 2419 (1992) ("As interstate commerce has become ubiquitous, activities once

paradigm "traditional state functions" the Tenth Amendment protects from federal intrusion.

Although *New York* suggests that "commandeering state legislatures" presents an issue different from that faced in *National League* and *Garcia*, it represents a clear shift from the message of *Garcia*,[42] toward the idea that there is indeed substance to the Tenth Amendment.[43] Notwithstanding the Court's suggestion that the issue is the wholly distinct one discussed in *FERC* and *Hodel*,[44] critical evaluation prompts the conclusion that there is a confluence of these two lines of cases that might prohibit Congress from implementing EPCRA directly. I reach this conclusion in two steps. The first is the observation that *New York*'s limitation of *Garcia* is analytically indistinguishable from the test in *National League*. The second is the argument that protection of the core state functions identified by *National League* might prohibit Congress from implementing EPCRA directly. I will discuss these two steps in turn.

1. Constriction of Garcia Toward Revival of National League.—In *Garcia*, the majority suggested that states are protected from federal overreaching through their participation in the national political process rather than by any substantive limits imposed by the Tenth Amendment. Commenting on the difficulties with a self-policing Congress,[45] Justice Powell's dissent in *Garcia* observed that the majority did not identify any aspect of state sovereignty that could not be invaded by an assertion of ostensible Commerce Clause power.[46] From this perspective, the protective boundary *New York* erects around the state legislative process is a clear limitation on *Garcia*.

---

considered purely local have come to *have effects* on the national economy, and have accordingly come within the scope of Congress' commerce power.") (emphasis added).

42. *Garcia* reversed *National League* over the vigorous dissent of Justice O'Connor, who wrote for the majority in *New York*. *Garcia*, 469 U.S. 528. The majority in *Garcia* concluded that there was no special body of state activities protected by the Tenth Amendment. Instead, the Court concluded that the states' participation in the national political process established a procedural safety net. Importantly, the *Garcia* decision lamented the struggle prompted by *National League* in defining protected "traditional state government functions." Calling it unworkable, the Court abandoned this "historical standard." The Court then flirted briefly with a "necessity standard," which identified functions that seem essential for state or local governments to provide. *Id.* at 545. The Court rejected the necessity standard, seemingly because the range of protected functions would be too narrow. *Id.* at 544. But even within that "too narrow" standard, the emergency services regulated by EPCRA seem to fit easily. This is illustrated by the utter impracticability of the federal government providing such services. *See infra* notes 71-76; 81-83 and accompanying text.

43. "This case presents no occasion to apply or revisit the holdings of any of these cases, as this is not a case in which Congress has subjected a State to the same legislation applicable to private parties." *New York*, 112 S. Ct. at 2420.

44. *Id.*

45. *See Garcia*, 469 U.S. at 565 n.12, 575 (Powell, J., dissenting).

46. *Id.* at 579.

Examination of the guiding principle of *National League* illustrates its confluence with *New York*. In *Hodel*,[47] the Court aptly summarized *National League* as distinguishing between permissible regulation of individuals, and impermissible regulation of states *qua* states.[48] Direct orders to legislatures and local agencies prescribing how they must perform their missions look a great deal like regulation of states *qua* states. Indeed, commandeering the state legislative process may be closer to the core of such prohibited regulation. In *New York*, the Court established the state legislative process as sacrosanct, just as *National League* attempted to insulate ill-defined "traditional government functions." The only real difference between the two cases is that *New York*'s prohibition against commandeering the legislative process is a brighter line. True, *New York* did not involve the application of a generally applicable statute to core state functions. However, the guiding question—have core state functions been invaded?—remains the same. The only difference is the style of the invasion.[49]

2. Prohibiting Federal Implementation.—A critique of EPCRA against the backdrop of *New York* invites a revival of *National League*'s protected state prerogatives.[50] *New York* suggests that the state legislative process is one of the core activities protected by the Tenth Amendment. The open question is what other activities stand with the legislative process inside this protective boundary?[51] The confluence between *National League* and *New York* suggests it is fair to identify *National League*'s paradigm "traditional state

---

47. 452 U.S. 264, 293 (1981).

48. The question in *National League* was whether Congress could subject states, exercising traditional state functions, to generally applicable statutes that it clearly had the power to promulgate under the Commerce Clause. The Court gives this illustration of integral state government functions: "While there are obvious differences between schools and hospitals involved in *Wirtz* and the fire and police departments affected here, each provides an integral portion of those governmental services which the States and their political subdivisions have traditionally afforded their citizens." National League of Cities v. Usery, 426 U.S. 833, 855 (1976).

49. *See generally* New York v. United States, 112 S. Ct. 2408, 2435 (1992) (White, J. dissenting).

50. Justice O'Connor's dissent in *Garcia* suggests an ultimate return to the principles of *National League*. *See Garcia*, 469 U.S. at 589 (O'Connor, J., dissenting).

51. The Court has intimated that the protective boundaries of the Tenth Amendment go beyond prohibiting coerced state regulation. "Whatever the outer limits of [state] sovereignty may be, one thing is clear: The Federal Government may not compel the States to enact or administer a federal regulatory program." *New York*, 112 S. Ct. at 2435. If this statement is predictive, it is fair to consider federal duplication of local fire departments and state legislatures to be equally offensive. If, however, the Court wishes to narrow the impact of *New York* in the future, it might distinguish federal intrusion into the state legislative process by labelling it especially offensive. On the heels of such a distinction, federal duplication of local fire departments might be tolerated.

This distinction would be unremarkable. By any measure, federal duplication of state legislative activities is more troublesome then duplication of local fire departments. But if such a distinction is made, it may mean the state legislative process is the only thing *New York* protects.

functions" as core state activities eligible for the same Tenth Amendment protection.[52]

If these activities are protected to the same extent *New York* protected the state legislative process, Congress arguably is prevented from usurping state control by regulating them directly. *New York* illustrates that, regardless of the tactic employed, Congress simply cannot force states to adopt a regulatory program. If community decisions about fire, emergency and police response services are accorded the same protection as legislative decisions, it should not make a difference whether Congress orders states to create a regulatory structure imposing federal procedures on local fire departments, attempts to usurp those community/state functions by imposing response procedures directly on fire departments and emergency teams, or duplicates those functions with federal personnel.[53] Limiting Congress in this way would begin to mark the territory that is protected from the seemingly omnipotent Commerce Clause. This demarcation may be essential if the Court is serious about maintaining a substantive Tenth Amendment.[54]

---

52. EPCRA transmits federal commands to local fire departments concerning the types of preparation they must do to meet local emergencies. *See, e.g.,* EPCRA § 303. It dictates implicitly how state and local governments will choose to fund their emergency response programs. *Id.* Further, it imposes federal penalties for breaches of the federally mandated relationship between regulated entities and local government agencies. *Id.* § 325. EPCRA, Sections 301 and 303 require action by local health workers, fire departments, state regulatory agencies (including a broad range of local players on emergency planning committees) and others. *See supra* note 14. Certain sections of EPCRA are particularly vulnerable to this criticism. Reading sections 301 through 303 of EPCRA conjures up images of a federally mandated "town hall." See EPCRA § 301(c) for a good illustration of federal directions to local planning committees. Some of the most intrusive examples appear in section 303(c), which mandates the establishment of training programs and response procedures "local emergency and medical personnel must follow." *See also id.* § 303 (requiring the state commission to assert jurisdiction over covered facilities and to identify those facilities to the administrator); *id.* § 324 (requiring committees to collect, store and make data available to the public and limiting other states' use of this data).

Not all portions of EPCRA get caught in the potential snare cited by the *Garcia* dissenters. Section 313 for example is largely a direct federal order to private parties to report certain information to federal and state officials. It might, in small part, breach the *New York* prohibition against coerced state legislation because it implies that states must have a place to receive and store this information.

53. *Cf.* Pennsylvania v. EPA, 500 F.2d 246 (3rd Cir. 1974) (direct federal implementation of transportation control plans would be no less an intrusion on state sovereignty than ordering states to implement federal standards).

54. In his *New York* dissent, Justice White suggests *Garcia* offers the better test: "Any substantive restraint on the exercise of Commerce Clause powers must find its justification in the procedural nature of this basic limitation, and it must be tailored to compensate for possible failings in the national political process rather than to dictate a 'sacred province of state autonomy.'" *Id.* at 2443-44 (citing *Garcia*). Whether the ribbon of theoretical protection *Garcia* offers would require invalidation of EPCRA is beyond the scope of this analysis.

C. Can the EPCRA be Saved by Characterizing its Command to States as Merely Directory?

We might attempt to distinguish EPCRA from the legislation invalidated in *New York* by suggesting that it really does not commandeer the state political process at all; that the federal command is directory rather than mandatory.[55] The court in *District of Columbia v. Train*[56] made this distinction in construing a Clean Air Act provision. The *Train* court construed the mandate requiring states to submit implementation plans to be directory rather than mandatory.[57] Pivotal to this conclusion was the Clean Air Act's federal implementation option that was activated if states chose not to submit a state implementation plan. The court characterized the statute's ostensibly mandatory language as directory in the context of a classic cooperative federalism choice.[58]

The option of direct federal implementation is not contained in EPCRA. Absent that alternative, it is difficult to suggest that Congress' command to governors is only a *Train*-style suggestion.

EPCRA's enforcement provisions also show that the congressional command is not just a poorly phrased request. Section 326 of EPCRA[59] explicitly authorizes civil actions against the administrator, regulated entities and state officials. Section 326(a)(1)(C) authorizes citizens to sue a governor or a commission for "failure to provide a mechanism for public availability of information in accordance with section 324(a)." Construed broadly, this language authorizes a variety of actions, including one against a governor who refuses to implement EPCRA.[60]

---

55. "[T]he governor of each state shall. . ." EPCRA § 301; 42 U.S.C. § 11001.

56. 521 F.2d 971, 986 (D.C. Cir. 1975).

57. *Id.* The *Train* court supported this conclusion on the grounds that the statute read as a whole, did not intend to force legislatures (on the threat of civil penalties) and municipal governments to enact legislation and regulations.

58. The CAA authorized federal implementation if the state refused.

59. 42 U.S.C. § 11046.

60. EPCRA is distinct from the Radioactive Waste Act in that the sanction applied to recalcitrant states is nominal. In comparison, the fiscal impact of taking title to low-level radioactive waste looms large. Failure to comply with EPCRA generates at most civil enforcement and mandamus actions, and liability for attorney's fees. *See infra* text accompanying notes 61-62.

Given that sanctions for a state's failure to comply with EPCRA are less severe than those in *New York*, it is tempting to say EPCRA, despite its language, really does not coerce anything; that either the statute is directory rather than mandatory, or it will be treated as such by the EPA. While the absence of severe sanctions may say something about how serious Congress considered the problems EPCRA addresses, it is not a license to reinterpret the congressional command.

The statute at issue in *FERC* (PURPA) was similar. No penalties attached if state agencies failed to meet PURPA standards by the deadline. FERC v. Mississippi, 456 U.S. 742 (1982). PURPA gave private parties certain procedural rights before state utility commissions. *Id.* It did not contain any direct statutory penalty that would punish the utility commission for failure to respect those procedural rights. A commission that failed might be subjected to the same type of

Interestingly, while the statute prescribes a remedy in actions against the administrator or against a facility owner under section 326(a), it does not prescribe a remedy against a governor or a commission in suits brought under section 326(a)(1)(C).[61] One might construe the absence of a prescribed remedy as an indication that the command to governors is only directory. But that faces its own obstacle.

Section 326(g) of EPCRA provides: "Nothing in this section shall restrict or expand any right which any person (or class of persons) may have under any Federal or State statute or common law to seek enforcement of any requirement or to seek any other relief (including relief against the Administrator or a State agency)." If authorization were needed, this language seems to permit enforcement through a common law mandamus action.[62]

If a party brings a mandamus action, or if she brings a common law or statutory action under section 326(a)(C), the United States retains the right to intervene.[63] This power to intervene raises the possibility of the administrator standing before a judge and successfully arguing that a recalcitrant governor

---

mandamus action that is an enforcement mechanism under EPCRA. There was no contention that the absence of monetary penalties or other sanctions against a noncompliant utility commission made the statute directory.

61. However, pursuant to section 326(f) of EPCRA, a governor who loses such an action must pay plaintiff's attorney's fees. *Cf.* EPCRA § 325 (setting $25,000 per day penalties for reporting violations by covered facilities).

EPCRA authorizes monetary penalties against state officials or agents, although not as a sanction for refusing to implement the program. Section 325(d)(2) imposes a $20,000 fine or imprisonment against "any person who knowingly . . . divulges [protected trade secret information]" received from a regulated facility.

Conceivably, this could result in a criminal sanction issued against a state official who would have chosen not to become involved with EPCRA. However, this provision is merely a detail of implementation. These penalties would not apply if a state simply refused to implement EPCRA. They are not within the mold of the "take title" penalty addressed in *New York.* Indeed, they appear more closely related to the generally applicable federal requirement that the Court critiqued in *National League* and *Garcia.*

62. Before a court will issue a writ of mandamus, a defendant must fail to perform the act in question, the plaintiff must have the right to demand relief, and there must be no alternative remedy. Timken Co. v. United States, 893 F.2d 337 (Fed. Cir. 1990). Mandamus is an extraordinary writ, which lies to compel performance of a ministerial act or a mandatory duty where there is a clear legal right in the plaintiff, and a corresponding duty in the defendant. Jones v. Packel, 342 A.2d 434 (Pa. Commw. Ct. 1975).

At least to the extent that the governor acting as the commission constitutes "a state agency", section 326 of EPCRA explicitly authorizes a mandamus or other action against him. It also authorizes citizens to bring available common law actions against the state commission or committees who refuse to follow the federal commands in EPCRA.

True, a mandamus action might not be brought or might be unsuccessful. But the same is true for EPA enforcement actions under a variety of statutes. The possibility that any particular EPA enforcement action may be more likely to succeed than an EPCRA mandamus action is a difference of degree rather than substance.

63. EPCRA § 326(h); 42 U.S.C. § 11046.

should be forced to comply with EPCRA.[64] It is then difficult to view EPCRA's orders to regulate as unenforceable requests.

D. Is it Curative if the EPA Treats the Congressional Command as a Request?

Suppose EPA, by administrative fiat, treats EPCRA's command to governors as if it were discretionary?[65] Initially, there are practical problems with this approach. The first is whether such a commitment is reliable. We already know from *EPA v. Brown*[66] that the agency has, arguably with less justification, attempted to treat similar language as if it were mandatory.[67] Second, such a commitment does nothing to prohibit a citizen's suit pursuant to section 1046 of EPCRA.[68]

But there is a deeper problem. Endorsing curative non-enforcement by EPA sanctions a dangerous shift of authority away from Congress to bureaucrats. It allows EPA to disregard Congress's explicit instructions, perhaps usurping the role of courts in statutory interpretation, and to pursue its own remedial policy. If this "solution" is not troubling, it suggests we are much more comfortable with the shift of decision-making to non-elected administrators than we ought to be.[69]

Even with the enormous expansion of Congress' ability to delegate legislative power, nothing so far suggests that agencies may disregard legislative commands that seem to be problematic, thereby "curing" constitu-

---

64. Not surprisingly, EPA is given no power to assess penalties directly against governors who refuse to comply with the congressional command. The Clean Air Act challenges that culminated in EPA v. Brown, 431 U.S. 99 (1977), demonstrate the folly of that approach. *See, e.g.*, Maryland v. EPA, 530 F.2d 215, 224-25 (4th Cir. 1975) ("In a nutshell, the EPA has directed Maryland and her legislature to legislate under pain of civil and criminal penalties . . . if there is any attribute of sovereignty left to the states it is the right of their legislatures to pass, or not to pass, laws.") The "take title" provisions in the Radioactive Waste Act, struck down in *New York*, were just a slightly more subtle variation of the same thing. *See also* EPCRA § 325(c) (explicitly exempting government entities from civil penalties for reporting violations).

65. There is certainly precedent for this. *See, e.g.*, Les v. Reilly, 968 F.2d 985 (9th Cir. 1992). In *Les*, the court ordered EPA to enforce the Delany Clause (part of a scheme of federal pesticide regulations), which prevents processed food from containing *any* cancer-causing pesticides. *Id.* at 988. EPA had, by administrative fiat, reinterpreted and ignored (on the grounds that it was impractical) what the court found to be clear statutory language. "The EPA in effect asks us to approve what it deems to be a more enlightened system than that which Congress established. . . . Revising the existing statutory scheme is neither our function nor the function of the EPA." *Id.* at 990.

66. 431 U.S. 99 (1977).

67. *See supra* note 31.

68. It is also unclear whether such a commitment would translate into an obligation to intervene in support of the position that the statute's commands are not mandatory.

69. Many of us were troubled during the Iran/Contra affair by the idea of the legislature being supplanted by a group of people who "knew better than Congress" how to address a different type of problem.

tional infractions. Indeed, in a recent criticism of EPA's effort to "correct" a statute regulating pesticides, the Ninth Circuit confirmed what we should know already: "The EPA in effect asks us to approve what it deems to be a more enlightened system than that which Congress established. Revising the existing statutory scheme is neither our function nor the function of the EPA."[70]

So long as we believe regulations and regulators derive from Congress, the rationalization that EPA will, by regulation or practice, "cure" Constitutional breaches by ignoring or reconstructing plain statutory language is insufficient and repugnant.

III. Steam-Rolling State Constitutions

EPCRA's collision with state governmental structures and constitutional principles underscores its breach of federalism.

A. Separation of Powers

The emergency response commission that EPCRA orders governors to create has many obligations and powers.[71] The commission is required to create and supervise local emergency planning committees that have even broader duties.[72] It is difficult to avoid the conclusion that the commission and the committees are state regulatory agencies limited by long-standing state constitutional principles.[73]

---

70. Les v. Reilly, 968 F.2d 985, 990 (9th Cir. 1992).

71. *See* EPCRA § 301(a); 42 U.S.C. § 11001(9). *See infra* note 73, which includes a description of some of the duties and obligations of the commission.

72. *See* EPCRA §§ 301(b), (c); 42 U.S.C. §§ 11001(b), (c).

73. These entities have considerable power to alter the legal rights and duties of facilities covered by EPCRA. Both state and federal courts have used these factors to characterize action that constitutes lawmaking. *See* Immigration & Naturalization Serv. v. Chadha, 462 U.S. 919, 952 (1983) (defining lawmaking as "altering the legal rights, duties, and relations of persons"); Commonwealth v. Sessoms, 532 A.2d 775 (Pa. 1987) (using alteration of legal rights and duties as a guide for defining legislative activity that must be considered lawmaking).

The legislature may not delegate its legislative function, but it may authorize an agency to carry out legislative intent described in general terms through rules, regulations and standards established by the agency. Bortz Coal Co. v. Air Pollution Comm'n, 279 A.2d 388 (Pa. Commw. Ct. 1971). Agency rules and regulations, when properly adopted, have the force and effect of law. Commonwealth v. State Conference of State Police Lodges of the Fraternal Order of Police, 520 A.2d 25 (Pa. Commw. Ct. 1987). Regulation has the same legal force and effect as a statute. Commonwealth v. A.J. Wood Co., 431 A.2d 367 (Pa. Commw. Ct. 1981). The Pennsylvania legislature has acknowledged by statute that the state surrogate for the EPCRA commission will "regulate." *See* PA. STAT. ANN. tit. 35 § 6022.213 (1990).

Numerous provisions of EPCRA illustrate that the commission and committees act as traditional state regulatory agencies whose powers must derive from the legislature. The commission is directed under section 301(a) to appoint an official to coordinate information provided under the program's guidelines. *See* 42 U.S.C. § 11001(a).

Where the authority to create statutes enabling and funding regulatory agencies is vested in the legislature, EPCRA's breach of federalism is compounded.[74] By ordering governors to create and fund state regulatory agencies,[75] EPCRA forces the executive branch to exercise legislative powers in violation of core state separation of powers principles.[76]

The committees are formed for purposes of facilitating "preparation and implementation of emergency plans." *See* 42 U.S.C. § 11003(b). Section 301(b) of EPCRA generally requires the commission to establish jurisdictional boundaries in the form of emergency planning districts. *See* 42 U.S.C. § 1100(b). Section 303(1)(b) directs the committees to identify facilities subject to the jurisdiction of the emergency plan and to define methods to be used by facility owners and emergency personnel to respond to a release. It directs the committees to designate emergency coordinators who "shall" make decisions necessary to implement the plan and to develop procedures for giving public notice of covered releases. *See* 42 U.S.C. § 11003(c).

Planning committees are required by section 301(c) to establish internal rules of governance covering public notice of committee activities, public comments, discussion of emergency plans, committee responses to citizens' inquiries and distribution of the emergency plan. *See* 42 U.S.C. § 11001(c).

The committees are required to develop an emergency plan. The parameters of that plan are designated in the statute. Facilities that fail to provide the committee with information required to prepare the plan are subject to civil penalties and enforcement actions by EPA. *See* EPCRA § 325; 42 U.S.C. § 11045(a).

74. Pennsylvania law illustrates these constraints. *See* Bloomingdales By Mail, Ltd. v. Commonwealth Dep't of Revenue, 516 A.2d 827 (Pa. Commw. Ct. 1986) (Agencies are creatures of statute and cannot exercise powers not explicitly given them by the legislature.); Borough of Blawnox Council v. Olszewski, 477 A.2d 1322, 327 (Pa. 1984) ("the power and authority exercised by administrative commissions derives from legislative grant of power"); Pennsylvania Human Relations Comm'n v. St. Joe Minerals Corp. Zinc Smelting Div., 357 A.2d 233 (Pa. Commw. Ct. 1976) (The power of an administrative agency must be sculpted precisely so that its operational figure strictly resembles its legislative model.).

75. These include the commission directly and the committees, through the delegation of dubiously derived executive power to the commission. *See infra* Section III.B. of this Article for a discussion of the problems with delegation of federal power to governors to create state agencies.

76. EPCRA apparently anticipates that governors will implement its commands by executive order. Indeed, at its inception EPCRA was implemented almost exclusively by executive order. *See* CENTER FOR POLICY RESEARCH, NATIONAL GOVERNORS' ASS'N, EMERGENCY PLANNING AND COMMUNITY RIGHT TO KNOW ACT: A STATUS OF STATE ACTIONS (1988) [hereinafter NGA REPORT]. This publication describes the details of the initial implementation of EPCRA in each state.

The basis for initial implementation in Pennsylvania was Executive Order No. 1987-8 (1987). Although no one formally objected, this ranged well beyond the legitimate use of executive orders. In *Shapp v. Butera*, 348 A.2d 910 (Pa. Commw. Ct. 1975), the Pennsylvania Commonwealth Court described the limitations on executive orders. There are three classes of orders. The first two, proclamations and orders in the nature of requests to subordinates, are legally unenforceable. The third category may have legal effect, but must be "based upon the presence of some constitutional or statutory provision which authorizes the executive order either specifically or by way of necessary implication. . . . The Governor's power is to execute the laws and not to create or interpret them." *Id.* at 913-14.

There was no statutory authorization for executive order 1987-8. *See* 71 PA. CONS. STAT. § 241 (1992). It is difficult to find anything in the enumerated powers of the Executive in the Pennsylvania Constitution that authorizes an executive order implementing EPCRA. PA. CONST.

B. Delegation

EPCRA collides with state delegation doctrine in at least two ways. First, it may require states to give regulatory agencies powers that are beyond the scope of legitimate delegation of state legislative authority. While the non-delegation doctrine may be a dead letter at the federal level, it survives as a principle of state law that prohibits assignments of lawmaking authority.[77] It is a state constitutional decision whether particular powers should be given to any administrative agency.[78] EPCRA usurps states' decisions about the things that should be undertaken through direct legislation rather than by non-elected bureaucrats.[79] It seems simply to presume either that state constitutional law mimics federal delegation principles, or should be ignored in lieu of federal principles.

Second, absent an explicit grant of power from the state legislature, the committees' or a commission's rule-making activity again violates state delegation principles. It is a state legislative decision whether to create state regulatory agencies with the powers of the commission and committees. Because EPCRA does not generate a state statute from which their authority

---

art. IV. Indeed, there is no mention in the Constitution of Executive Orders. *Shapp*, 348 A.2d at 912. *See also* National Solid Wastes Management Ass'n v. Casey, 600 A.2d 260 (Pa. 1991) (The *Casey* court ruled that a state constitutional right to a clean environment did not authorize the governor to legislate through an executive order limiting permits for new landfills.).

Pennsylvania's separation of state government functions is typical. It separates the legislature's power to create regulatory agencies and the executive's power to direct agency execution of legislative instructions. *See* Nicholas J. Johnson, *There May be Cracks in the Foundation: An Analysis of Pennsylvania's Current Approach to Legislative Review of Agency Rulemaking*, 94 DICK. L. REV. 637 n.16, 26 (1990).

Implicit in EPCRA is also a command to provide the funding its agencies require. Section 324(a) requires that the state have facilities to create the emergency plan and make coliected information available. Section 324(b) requires the committee to publish a notice regarding the availability of the emergency plan and MSDS sheets each year. Pennsylvania's legislative response to EPCRA makes clear that fulfilling these and other commands requires state funding. *See infra* note 114. The executive summary of the NGA report is critical of the statute because it created funding obligations, but provided no dollars. It reflects the fact that EPCRA imposed funding obligations on governors beyond their powers, emphasizing that EPCRA's timetables conflicted with governors' schedules for sending budgets to the legislature. NGA REPORT, *supra* at 7.

77. Some assert that federal administrative agencies have exceeded their power to administer and enforce legislative instructions. They argue that agencies are exercising quasi-legislative power under enabling statutes almost completely devoid of standards. *See, e.g.*, Cynthia R. Farina, *Statutory Interpretation and the Balance of Power in the Administrative State*, 89 COLUM. L. REV. 452 (1989). This erosion of the principles constraining delegation of legislative power has been resisted at the state level. *See* Gilligan v. Horse Racing Comm'n, 422 A.2d 487 (Pa. 1980); Johnson, *supra* note 76.

78. *See, e.g., Gilligan*, 422 A.2d 487.

79. If a state legislature decided that it would not delegate legislative power at all—that it would have no administrative agencies—would EPCRA reverse that fundamental choice?

derives, any action by these agencies is an invalid exercise of regulatory authority.[80] The revolution in state constitutional law that would validate assignment of federal legislative power, through governors, to state regulatory agencies would signal the demise of the federal system.[81] Under such a scheme, asking whether the state agency had exceeded its authority would require the *ultra vires* determination to be gauged against a *federal* statute. Unless we are prepared to permit Congress completely to supplant state legislatures, a delegation of federal legislative power to a state chief executive is insufficient to empower state regulatory agencies.

C. Pennsylvania's Response Highlights EPCRA's Intrusion

One state's reaction to the statute further illustrates EPCRA's breach of federalism. Reflecting the prerequisites to creating state regulatory agencies like the commission and committees, the Pennsylvania legislature enacted the Hazardous Material Emergency Planning and Response Act ("Act").[82] It establishes a state legislative framework for implementing EPCRA's directives. Through provisions that fund and delegate legislative power to surrogates for the commission and committees,[83] the Pennsylvania statute highlights the fact

---

80. The legislature may delegate enforcement authority to administrative agencies of the executive branch so long as those delegated powers are controlled by adequate standards. *See generally* Tosto v. Nursing Home Loan Agency, 331 A.2d 198 (Pa. 1975). Legislation must contain adequate standards that will guide and restrain the exercise of delegated administrative functions to withstand attacks based upon alleged delegations of legislative power. *See* Chartiers Valley Joint Schools v. County Bd. of School Directors of Alleghany County, 211 A.2d 487 (Pa. 1965). The legislature may not delegate its legislative function but it may authorize an agency to carry out legislative intent described in general terms through rules regulations and standards. *See* Bortz Coal Co. v. Air Pollution Comm'n, 279 A.2d 388 (Pa. Commw. Ct. 1971). An administrative agency, being a creature of the legislature, is vested only with those powers conferred by statute. *See* Demarco v. Commonwealth Dep't of Health, 397 A.2d 61 (Pa. Commw. Ct. 1979).

If EPCRA attempted to generate legitimate state authority for creation of these agencies, its violation of federalism would be underscored. Such a "curative" step would require a congressional command directly to state legislatures, ordering them to delegate state legislative authority to agencies Congress wishes to create. As the Court explained in *New York*, Congress is prohibited from commandeering state legislatures as vehicles for implementation of the federal regulatory agenda. *See* New York v. United States, 112 S. Ct. 2408, 2420 (1992).

81. Another rendition of this problem combines state rulemaking and federal enforcement. EPCRA forces states to create state agencies and then usurps their enforcement authority. In order to prepare emergency plans required under section 303(b), committees have the power to request necessary information from covered facilities. However, where a covered facility fails to provide that information, EPA is given jurisdiction over the enforcement and penalty action. Collected penalties of up to $25,000 per violation go into the federal treasury, not the state treasury. *See* 42 U.S.C. § 11045.

82. PA. STAT. ANN., tit. 35, § 6022.101 et. seq. (1990).

83. Section 102 of the Emergency Response Act designates the Pennsylvania Emergency Management Council as the emergency response commission and establishes districts and committees in each county of the commonwealth in accordance with EPCRA. It empowers the

that EPCRA commands governors to act within the exclusive domain of state legislatures.

State attempts to pursue the goals of EPCRA through legislative channels do not eliminate EPCRA's violations of federalism. Regardless of a state's response, EPCRA's commands to create and fund regulatory agencies remain invalid.[84] Indeed, in at least one aspect, states like Pennsylvania have failed to comply with EPCRA because the legislature, rather than the governor, has created the emergency response commission.[85] Moreover, in states where the legislature has not pursued EPCRA's goals through valid legislation, the statute stands in its most offensive posture, with states having acquiesced to the federal intrusion and sacrificed their constitutional principles.[86]

---

council to "carry out the responsibilities assigned to the commonwealth by [EPCRA]" and gives the council state regulatory authority to meet the federal obligations to administer emergency planning committees.

Section 102(d) authorizes reimbursement of members of the council for actual expenses. This recognizes the need for state funding of these federally ordered state agencies.

Section 102(g) authorizes the council to carry out all duties and responsibilities required of the commission under EPCRA including promulgation of *required regulations* to ensure that local committees meet federal standards, and to do all other things necessary for implementation of EPCRA.

Section 201(h) establishes a separate operating budget to provide necessary funding, which the governor could not authorize.

Section 203(g) requires the council to set up procedures for complying with responsibilities EPCRA assigns to planning committees.

Section 203(k) identifies state emergency plan requirements by reference to the EPCRA plan requirements.

Section 207(a) creates a fund to carry out the purposes of EPCRA. A minimum of seventy percent of revenue shall be given to the committees as grants to support the activity at the county level. The dollars come from a variety of new fees imposed on state residents.

Section 208 sets up a "grant" fund (seventy percent of the council's funding must be spent on these grants) to pay the costs of "developing . . . emergency response plans required by [section 303 of EPCRA], . . . performing public information functions as required by [section 324 of EPCRA], and collecting, documenting and processing chemical inventory forms and other documents required by [EPCRA]."

Section 213 directly acknowledges that the council will "regulate."

84. *See supra* text accompanying notes 2-14.

85. *See* PA. STAT. ANN. tit. 35, § 6022.201 (1990). Through Pennsylvania Executive Order No. 1987-8 (1987), Pennsylvania originally attempted to comply with the letter of EPCRA. Note 76 discusses the state constitutional violation generated by that order. One is tempted to say "So what, why should we care about such trivial procedural burrs when the goal of safer communities is achieved?" But it is precisely this tension that is an unyielding danger in the larger constitutional context. If federalism becomes merely a trivial, procedural concern, then it evaporates as a barrier to a federal government that can go anywhere and do anything. True, unlimited federal power may have enormous utility in solving increasingly complex problems. Nevertheless, as the framers recognized, such plenary power can be wielded for good or ill.

86. Initially, most states attempted to comply with EPCRA through constitutionally suspect executive orders. *See supra* note 76. Several states now have statutes providing explicit legislative authorization for implementing EPCRA. *See, e.g.*, DEL. CODE ANN. tit 16, § 6310 (1992); FLA. STAT. ANN. § 252.81 *et. seq.* (1991); MASS. GEN LAWS ANN. ch. 21E, § 1 *et. seq.*

State acquiescence does not cure EPCRA. As the Court explained in *New York*, Congress' constitutional authority cannot be expanded by the "consent of the governmental unit whose domain is narrowed . . . . State officials thus cannot consent to the enlargement of the powers of Congress beyond those enumerated in the Constitution."[87]

Acquiescence by states might indicate that EPCRA is a good thing, or at least is harmless.[88] But the Constitution repels the idea that Congress' power is unlimited so long as it is exercised for arguably noble goals.

D. EPCRA's Non-preemption Clause: An Impotent Savior?

Section 321(a) of EPCRA says that nothing in the statute shall preempt any state or local law. The temptation is to conclude that this validates EPCRA by diffusing its coercive commands. However, even giving this provision broad reading does not cure the fundamental problem—*i.e.*, that the statue commands states to regulate. It is the Tenth Amendment and the United States Constitution that EPCRA primarily assaults. EPCRA's non-preemption clause does nothing to avoid that violation.

Moreover, if EPCRA truly will not preempt state law, then it may be self-canceling. Deference to the above-described state law principles[89] may mean that EPCRA's structure collapses, that the commands to governors cannot stand, and that the assignment of functions to the commission and committees is invalid.

Even if the congressional command were issued to the body with authority to create regulatory agencies, the most offensive aspect of EPCRA—congressionally coerced state regulation—would remain. That Congress' command would issue to the legislature rather than the governor would make no difference.

By feigning respect for state autonomy, the non-preemption clause causes the statute to stumble over other aspects of state governmental structure that underscore EPCRA's collision with federalism. In Pennsylvania, for example, there are various prerequisites to agency rulemaking, including a rule review process.[90] Through its non-preemption section, EPCRA apparently bows to this process. Pennsylvania rule review would require the proposed rules of

---

(1989); N.D. CENT. CODE § 37-17.1-07.1 (1991); S.D. CODIFIED LAWS § 34A-12-21 (1992); VA. CODE ANN. § 44-146.34 (1993).

87. New York v. United States, 112 S. Ct. 2408, 2432 (1992). Federalism is a protection of individuals, not state governments or state officials. This division of power reduces the risk of federal and state tyranny and abuse. *Id.*

88. Struggling companies faced with up to $25,000 civil penalties per violation for true paperwork infractions may have a different view.

89. *See* Section III, parts A and B of this Article, which describe EPCRA's clash with state separation of powers and delegation principles.

90. *See supra* Johnson, note 76.

committees and the commission to pass through the Independent Regulatory Review Commission (IRRC). One function of the IRRC is to prompt disapproval of *ultra vires* agency regulations. By design, every action by a commission or a committee would emerge without state statutory authorization, inviting disapproval by the IRRC or a successful challenge by affected citizens.[91]

The non-preemption provision causes EPCRA to stumble into this and other procedural blackholes.[92] Such knots are signals that EPCRA improperly intertwines state and federal political structures.

IV. Understanding EPCRA as a Model and What it Portends for Federalism

A. Perceived Necessity

A substantial obstacle to a conclusion that Congress cannot impose EPCRA (either directly, or by commandeering states) is the perception of necessity that grows from a continually expanding definition of national problems that simply must be solved. The power of this perception of necessity is particularly apparent in critiques of environmental statutes[93] and

---

91. In states where EPCRA is implemented by executive order, an *ultra vires* challenge to commission and committee actions may be the best avenue of attack.

92. *See, e.g.*, Johnson, *supra* note 76 (describing similar rule review mechanisms in other states).

93. In Maryland v. EPA, 530 F.2d 215 (4th Cir. 1975), the court rejected EPA's bold assertion that the agency should have the power to order state regulation because "it is clearly necessary that [these efforts] be carried out at the state and local level." *Id.* at 225.

In Pennsylvania v. EPA, 500 F.2d 246 (3rd Cir. 1974) (the only decision approving EPA's efforts to force states to issue regulations implementing the CAA), the court accepted the necessity argument, concluding that a flood of federal counterparts to traditional state traffic control authorities would not violate state sovereignty any more than ordering states to regulate. The court noted:

> [U]nder the CAA, states retain responsibility for design and enforcement, subject to approval and enforcement by the administrator]. We believe that this approach represents a valid adaption of federalism principles to the need for increased federal involvement. The only alternative implementation would be for the Federal Government to assume some of the functions of traffic control and vehicle registration and directly enforce the programs contained in the various transportation control plans. The Administrator has determined that this would not be a practicable way of attaining national air quality standards . . . and we fail to see how this would represent less of an intrusion upon state sovereignty.

Id. at 262-63.

Even in *New York*, the Court seems in places almost apologetic in striking down the offensive act. New York v. United States, 112 S. Ct. 2408 (1992). Justice White's dissent in *New York* is driven significantly by necessity justifications. He notes that "[t]he imminence of a crisis in low level radioactive waste management cannot be overstated." *Id.* at 2436 (White, J., dissenting). This statement is relevant on the floor of Congress, but it is arguably irrelevant to the constitutionality of the statute.

ultimately may be sufficient to consume constitutional principles as subtle as federalism.

The decision in *District of Columbia v. Train*,[94] is instructive. The D.C. Circuit in *Train* upheld in part the requirement that states enforce (under a Clean Air Act federal implementation plan activated in the absence of a state implementation plan) federal emissions standards. The court used a de minimis burden analysis to validate the federal requirement, finding that the "state may comply . . . merely by requiring applicants for vehicle registration to submit a certificate of compliance obtained from federal officials or from private sources not manned by state personnel."[95] This still required state enabling legislation and a change in administrative regulations. Most importantly, it was absolutely mandatory. States could not opt out and place the entire regulatory burden upon Congress.

The court was sensitive to the fact that by this very small concession in the area of registration it was permitting Congress to compel state regulation. It also is apparent that the court was apprehensive about its concession and wished to avoid a headlong slide down this slippery slope:

> [The remaining transportation regulations seek] under the guise of the commerce power, to substitute compelled state regulation for permissible federal regulation . . . . Actually, in extending the commerce power to the tremendous limits it has been pressed in recent years, the Congress and the Courts are most probably exceeding the intent of those who wrote the Constitution.[96]

Given the court's clear apprehensions about expansion of the Commerce Clause power and the corresponding diminution of state autonomy, the minor concession to federal coercion may be explained as bald capitulation to the

---

See also FERC v. Mississippi, 456 U.S. 742, 770 (1982) (noting in dicta that requiring states to apply federal standards if they choose to be in a field is especially appropriate in the environmental area). It is not clear why the substantive area of regulation should make a difference, unless it is perceived that the "necessity" of cooperative regulation in that area is especially acute. *See also infra* subsection IV(B), entitled "Political Coercion" (arguing that standing against "necessary" problem solving on the basis of constitutional principles is a recipe for being demonized).

In her dissent in *FERC*, Justice O'Connor quotes Justice Harlan:

> Times of international unrest and domestic uncertainty are bound to produce temptations and pressures to depart from or temporize with traditional constitutional precepts or even to shortcut the process of change that the Constitution establishes.
>
> . . . .
>
> It is the special responsibility of lawyers, whether on or off the bench, to see to it that such things do not happen.

456 U.S. at 786.

94. 521 F.2d 971 (D.C. Cir. 1975).

95. *Id.* at 991-92.

96. *Id.* at 992 (quoting at length from an 1829 letter from James Madison to J.C. Cabell).

perception of necessity raised by the administrator.[97] Similar perceptions of necessity ultimately might lead the Supreme Court back to the position that Congress "simply must be permitted" to commandeer state legislatures.[98]

A substantial measure of perceived necessity seems to drive EPCRA. The very idea of a massive federal bureaucracy running parallel to every local fire department and county government is preposterous. EPCRA ignores the possibility that such direct regulation may be the only legitimate way to achieve Congress' goals.[99] It also illustrates Congress' reluctance to acknowledge practical limits on federal power.

EPCRA's breach of federalism can be understood as the path of least resistance in the face of perceived necessity for a federal solution to local hazardous materials emergencies. Congress has three options when faced with either practical or constitutional limitations on its power: (1) acknowledge the limitation and not attempt a federal solution; (2) address the limitation by beginning the process of a constitutional change that would legitimately broaden its power; or (3) finesse the limitation or ignore it, and hope that the Court and others are moved by the necessity of the legislation to do the same. The first two paths are the most difficult. The EPCRA model travels the third, which is the path of least resistance.[100]

B. Political Coercion

> No one expects Congress to obliterate the states, at least in one fell swoop. If there is any danger, it lies in the tyranny of small decisions - in the prospect that Congress will nibble away at state sovereignty, bit by bit, until someday essentially nothing is left but a gutted shell.
>
> -Laurence Tribe[101]

If we do a few small things—for example, (1) view EPCRA's coercive command as directory only; (2) ignore that EPCRA has traditional teeth to force state compliance; (3) ignore EPCRA's collision with state political structures;[102] or (4) merely push the Tenth Amendment toward the scrap

---

97. *See supra* note 93.

98. *See also supra* notes 33-34.

99. *But see supra* subsection II(B) (arguing that even this may not be a legitimate option). That critique suggests the purchase of state cooperation though the connection of EPCRA-style regulation to related federal funds may be the only legitimate alternative. This Article will not examine whether the requirement that the funds be related to the regulatory scheme would pose any substantial barrier to implementation. *See* New York v. United States, 112 S. Ct. 2408, 2423 (1992).

100. *But see* Maryland v. EPA, 530 F.2d 215, 227 (4th Cir. 1975) ("[C]onstitutional principles may not be violated for administrative expediency.").

101. *See* FERC v. Mississippi, 456 U.S. 742, 774-75 (1982) (Powell, J., concurring in part, dissenting in part) (quoting LAURENCE TRIBE, AMERICAN CONSTITUTIONAL LAW 302 (1978)).

102. *See supra* section III of this Article.

pile—EPCRA may become the model for eliciting the result presaged by Professor Tribe.

EPCRA's meager enforcement provisions do not explain states' acquiescence to the statute. The explanation lies instead in the political coercion EPCRA brings to bear. It is this political coercion that makes the EPCRA model a powerful threat to federalism.

Political coercion emerges most obviously in "good works legislation,"[103] of which EPCRA is archetypical. Under EPCRA, if the governor refuses to create the mandated committees and commissions, she becomes personally responsible for implementing the statute. Given the undeniable good intentions of EPCRA and the obscure role of federalism in popular debate, federal political leverage over a recalcitrant governor is substantial. A governor would face the charge that she has refused to comply with a "balanced, sensible"[104] effort to spare communities from the ravages of black hat industrialists. The ease with which she could be characterized as sacrificing public safety to petty concerns about her own power is plain.[105] In *New York*, the Court describes generally and laments this danger. Indeed, "[t]he facts of this case raise the possibility that powerful incentives might lead both federal and state officials to view departures from the federal structure to be in their personal interests."[106]

Enacted in the wake of the highly publicized Bhopal, India disaster, EPCRA was sold as a mechanism for avoiding similar events in the United States.[107] At best, it would have been politically naive to object to such a well-intentioned measure on the basis of a technicality such as federalism.[108]

The wonderful[109] (or terrible)[110] thing is that there is nothing to sug-

---

103. In *FERC*, Justice O'Connor seems to acknowledge the double-edged nature of such legislation, quoting from former Attorney General Edward Levi, who warned against Congress "loving the states to their demise." *FERC*, 456 U.S. at 787 (O'Connor, J., dissenting).

104. This seems to be the current mantra. Others will emerge with the same impact.

105. In popular forums, where this debate would occur, the imagery of Bhopal against the abstraction of federalism would be a pitiful mismatch.

106. New York v. United States, 112 S. Ct. 2408, 2432 (1992).

107. "[EPCRA] was enacted in response to growing concern over toxic chemical accidents, particularly the 1984 Bhopal, India disaster." NGA Report, *supra* note 76, at 3.

108. This presents a fundamental dilemma. How do we respect a structure based upon limited government power, where there is always a way to suggest using that power to do "good works" and where objecting to extensions of power is a quick way to be demonized.

109. Wonderful to those who would gladly give Congress the power to "do something" about everything. This may slightly overstate the case. However, as noted in *Train*, Congress' appetite to legislate seems to be greater than both its constitutional power and its practical resources. District of Columbia v. Train, 521 F.2d 971, 993 (D.C. Cir. 1975).

110. Terrible to those who think that scrapping inconvenient constitutional provisions (even those we don't like) is a recipe for the demise of others we really do like. Given the sordid history of the "states rights" battle cry, I am ambivalent about a strong revival of the Tenth Amendment. However, my fear is that, inconvenience being the test, other provisions that I like better, are headed for the same scrap heap as the Tenth Amendment. *See* Nicholas J. Johnson,

gest the Court would invalidate EPCRA-style political coercion standing alone.[111] Such coercion seems to be in the same phylum as the incentives the Court has long approved for obtaining "voluntary" state regulation—for example, tying federal funding to state implementation of federal standards and giving states a choice either to regulate or suffer federal regulation.[112]

Consequently, if we care about federalism, attention to the details that trigger EPCRA's constitutional infractions is crucial. If these are swept away as petty technicalities, substantive limits on federal power also may be swept away on the wings of other EPCRA-style, good-works legislation.

There is, however, a chance that despite its substantial coercive powers, the EPCRA model will wither from self-inflicted blows. It is not only state officials' fear of being cast in the black hat that makes political coercion work. An allied factor is general state dependency upon the federal purse.[113] However, with increasing strains on the federal treasury, Congress may become less a source of fiscal benefits and more a source of fiscal burdens. Increasingly, congressional mandates to states come without accompanying

---

Beyond the Second Amendment: An Individual Right to Arms Viewed Through the Ninth Amendment, 24 RUTGERS L.J. 1 (1992). Some of the more popular provisions may be headed the same way. *See, e.g.*, Steven Yarash, *Operation Clean Sweep: Is the Chicago Housing Authority Sweeping Away the Fourth Amendment?*, 86 NW L. REV. 1103 (1992).

111. Where states introduce their own legislation in an effort to properly comply with statues like EPCRA, the combination of an offensive statute and political coercion has its most sinister effect.

112. *See* New York v. United States, 112 S. Ct. 2408, 2423-24 (1992).

113. Congress' ability to coerce state action through the power of the federal purse may be consequence of the pitfall that noted Texas politician Coke Stevenson warned his fellow Texans against. Author Robert A. Caro recounts Stevenson's views about the role of government:

> [I]t was always tempting to have government come in and solve problems, but every bit of government help came with strings of bureaucratic regulation attached, and every string was a limitation on the most important thing we possess and have to leave to our children—the thing that made Texas and America great. Freedom. Individual liberty. Every time you accept a government program you are giving up some of your freedom for a temporary gain; you're selling your birthright for a mess of pottage.

ROBERT A. CARO, MEANS OF ASCENT: THE YEARS OF LYNDON JOHNSON 167 (1990).

federal funding.[114] If this continues, Congress' power to elicit compliance with EPCRA-style statutes may diminish as well.[115]

V. CONCLUSION

EPCRA forces the creation of state regulatory agencies by governors whose guiding instructions come from the federal legislature. Indeed, under certain sections, federal instructions come not from Congress, but from a federal agency acting under a delegation of congressional power.[116] This is a model for transformation of states into mere branches of the federal bureaucracy. It is this model that the Supreme Court has found so offensive to federalism.[117]

---

114. This reduces the tacit coercive power of the federal purse. In Brown v. EPA, 521 F.2d 827, 940 (9th Cir. 1975), the court discussed the phenomenon of voters losing control over state spending through federal legislation mandating state spending for federal programs.

Section 305 of EPCRA authorizes an appropriation of five million dollars per year for fiscal years 1987-1990 to the Federal Emergency Management Agency (FEMA). FEMA is directed to make grants to support programs of state and local governments, and to support university sponsored programs, which are designed to improve emergency planning, preparedness, mitigation, response, and recovery capabilities. Such grants may not exceed eighty percent of the cost of any such program. The remaining twenty percent of such costs shall be funded from non-federal sources. *See* EPCRA § 305(a)(2).

Even if a state program is lucky enough to obtain its maximum eighty percent allocation, there is no opting out of the expenditure to cover the remaining twenty percent. Even in the best case, Congress has forced those remaining expenditures into the state budget. It is instructive to compare this to Justice O'Connor's summary of the statutory scheme upheld in *Hodel*: "That statute is 'a program of cooperative federalism,' because it allows the States to choose either to work with Congress in pursuit of federal surface mining goals or to devote their legislative resources to other mining and land use problems." FERC v. Mississippi, 456 U.S. 742, 782 (1982) (O'Connor, J., dissenting).

A primary complaint at EPCRA's inception, was the fiscal burden it imposed. *See generally* NGA REPORT, *supra* note 76. A recent statement by a coalition of state and local government organizations contains numerous descriptions of congressional actions fueling a growing state and local discontent with federal mandates unaccompanied by funding. *See* Statement Before the National Press Club, by representatives of the U.S. Conference of Mayors, National Association of Counties, National League of Cities and City/County Management Association, announcing their effort to end costly mandates imposed by the federal government, but not funded in the federal budget. (Transcript on file with author).

115. In the war of sound bites, "You gave us a great idea, but no money to implement it" stands up well against, "This is a balanced sensible statute." *Cf. supra* note 105.

116. Under Section 303(f) of EPCRA, federally designated national response teams issue guidance to the committees governing the development of emergency plans.

Within the agency, instructions in EPA guidance documents are generally considered compulsory. *See, e.g.*, 1988 and 1992 EPCRA Penalty Policy Guidance. It is not clear whether the Emergency Plan Guidance referenced in section 303 is intended to have the same compulsory impact upon emergency planning committees. If the guidance is considered compulsory, it would further illustrate how far EPCRA goes in commandeering the states as branch offices of the federal bureaucracy.

117. *See* New York v. United States, 112 S. Ct. 2408, 2434 (1992) ("State governments are

Where then is the parade of opposition to EPCRA? Perhaps it is absent because EPCRA is so well-intentioned. It may be that we have experienced such an erosion of federalism and growth of federal power that Tenth Amendment objections to congressional "good works" seem petty.[118] The danger is that tolerating these breaches may destroy the foundation meant to stand against the evils that grow from concentrations of power.[119]

---

neither regional offices nor administrative agencies of the Federal Government. The positions occupied by state officials appear nowhere on the Federal Government's most detailed organizational chart."). The take title provisions of the Radioactive Waste Act were less offensive in this respect. Those provisions did not tread so heavily upon state separation of powers and delegation principles. They gave states the nominal "option" of not legislating by incurring a penalty.

118. Justice O'Connor at least, would disagree that federalism is an archaic formality. *See New York*, 112 S. Ct. at 2418 (citing a scholarly discussion of the continuing benefits of federalism). *See also* FERC v. Mississippi, 456 U.S. 742, 789 (O'Connor, J., dissenting) (characterizing states as laboratories of regulation producing useful models like Florida's stringent oil spill legislation).

Arguably it is irrelevant that the only function of federalism is to impair worthy political goals. The Court has shown in rhetoric if not in deed, that constitutional principles may not be sacrificed to political exigency. *See* Chadha v. Immigration Naturalization Serv., 462 U.S. 919 (1983). *Cf. supra* subsection IV(A) of this Article, which discusses "perceived necessity."

119. In closing the opinion in *New York*, Justice O'Connor gives a rich summary of the tension between well-intentioned efforts to solve undeniable problems and constraints upon government power meant to preserve our constitutional structure. *New York*, 112 S. Ct. at 243-35. *See also* O'Connor's dissent in FERC, quoting Justice Harlan's description of the framers' deep suspicions of "every form of all powerful central authority. To curb this evil they both allocated governmental power between state and national authorities, and divided the national power among three branches of government. Unless we zealously protect these distinctions, we risk upsetting the balance of power that buttresses our basic liberties." *FERC*, 456 U.S. at 786 (O'Connor, J., dissenting) (quoting John M. Harlan, *Thoughts at a Dedication: Keeping the Judicial Function in Balance*, 49 A.B.A. J. 943 (1963)).

Can a black scholar embrace these ideas without tripping over the racist baggage of "states rights?" I think so. Black folks have experienced instructive shifts in allies. In our early history in this country, certain states were relative havens, but the federal government was not a friend. In a subsequent shift, the federal government became (sometimes reluctantly) our savior from particular states. During a significant period, the federal judiciary was our savior. Over the last decade, the Court has become less friendly to the traditional civil rights agenda, and many of us have looked to the legislature as our new ally.

Given these shifts, it seems foolhardy to believe that our friends always will have influence in Washington. It seems equally foolhardy to deny the possibility that the growing power of the federal government might sometime be wielded by activists on the extreme right in ways decidedly against our interests. It takes no great effort to imagine the very troublesome exercises of plenary federal power by a radical right regime with a mandate to "restore America to the traditions that made it great."

Indiana Law Review

Volume 27 1994 Number 3

NOTES

Professional Malpractice and Federal Common Law in Thrift-Crisis Litigation: Is the FDIC a "Super-Receiver"?

Thomas A. Dickey*

Introduction

The bail-out of the troubled savings and loan (S&L) industry began in March of 1989 with the passage of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989[1] and continues today. A recent estimate of the total cost of the bail-out, before interest, is $190 billion,[2] and interest payments by the federal government could roughly double this estimate.[3] Taxpayers have paid and will continue to pay the majority of the bill for the savings and loan fiasco. Consequently, under immense public pressure, federal and state regulatory agencies, in litigation throughout the country, have been aggressively attempting to identify a meaningful class of defendants able to bear financial responsibility for the catastrophic losses suffered by S&L depositors and investors.[4]

In litigation of this sort, the defendants who appear to have the greatest complicity are usually the officers and directors of the failed S&L.[5] However, regulators, for various reasons, cannot expect to recover actual losses sustained

---

* J.D. Candidate, 1994, Indiana University School of Law—Indianapolis; B.S., 1989, Indiana University.

1. Pub. L. No. 101-73, 103 Stat. 183 (1989) (codified as amended in various sections throughout 12 U.S.C.).

2. Michael Arndt, *S&L's Back at the Trough; Bentsen Asks $45 Billion to "Complete the Job,"* Chi. Trib., Mar. 17, 1993, at 1. Estimates have declined since the beginning of the bail-out primarily because of "the wide gap present [in the financial markets] between low short-term rates paid to depositors and relatively high long-term rates S&L's get for loans and investments." *Id.*

3. *Id.*

4. *See, e.g.*, Linda Himelstein & Gail DeGeorge, *The Mud on the Fancy Law Firm*, Bus. Wk., Aug. 16, 1993, at 91; Richard M. Weintraub, *Collections by the RTC Approaching $400 Million*, Wash. Post, Aug. 7, 1993, at B1; Stephanie B. Goldberg, *Kaye Scholer: The Tremors Continue: Welcome to the Uncertainty*, A.B.A. J., July 1992, at 51; Patricia A. McCoy, *Emerging Theories of Liability for Outside Counsel and Independent Outside Auditors of Financial Institutions*, 637 PLI/Comm 219, at 1 (Oct.-Nov. 1992).

5. McCoy, *supra* note 4, at 1.

by the S&L from the S&L's officers and directors.[6] Most officers and directors do not have personal worth near the amount of losses sustained by their failed S&L,[7] and in some cases, those who have substantial personal assets may have absconded with them.[8] Many failed thrifts either did not maintain an officer and director (O&D) liability insurance policy or maintained an O&D policy with relatively low liability limits.[9] Also, many such O&D policies do not cover liability based upon fraud.[10] Thus, because regulators frequently prove fraudulent conduct by S&L officers or directors, recovery from an O&D insurance policy is rare.[11]

Regulators' inability to obtain adequate remuneration from most officers and directors has led to an increased focus on the role played by professionals[12] in the demise of the S&L industry. Professionals are particularly attractive targets in this type of litigation because they typically have the "deep pockets" from which regulators seek to recover S&L losses—in the form of large malpractice insurance policies.[13] Unlike regulators' claims against officers and directors, the claims against professionals rarely include allegations of fraud.[14] Typically, the evidence is insufficient to prove the professional engaged in fraudulent conduct.[15] In addition, a fraud-based judgment would not be covered by the typical professional malpractice insurance policy.[16] Thus, claims against professionals are usually brought for professional malpractice, breach of fiduciary duty, negligent misrepresentation, and breach of contract.[17]

This Note focuses on civil litigation where the Federal Deposit Insurance Corporation (FDIC), as receiver or conservator for a failed S&L, has brought a professional malpractice action against a professional who served an S&L

---

6. *Id.*

7. *Id.*

8. For example, federal authorities allege Tom Billman, owner of the failed Community Savings and Loan, fled the country with millions of dollars stashed in a Swiss bank while the FDIC is left to deal with his insolvent S&L. *Id.*

9. *Id.*

10. *Id.*

11. *Id.*

12. The professionals involved in the litigation which is the subject of this Note are primarily accountants who audited failed thrifts' financial statements, attorneys who counseled failed thrifts, and to a lesser extent, appraisers who conducted appraisals for the thrifts. When the term "professionals" is used throughout this Note it generally refers to this class of individuals.

13. McCoy, *supra* note 4, at 1.

14. *Id.* at 3.

15. *Id.* In fact, regulators often have proof that professionals were defrauded by an S&L's officers and directors. *E.g.*, FDIC v. O'Melveny & Meyers, 969 F.2d 744, 746 (9th Cir. 1992), *cert. granted*, 114 S. Ct. 543 (Nov. 29, 1993); FDIC v. Ernst & Young, 967 F.2d 166, 168 (5th Cir. 1992).

16. McCoy, *supra* note 4, at 3.

17. *Id.*

prior to the S&L's failure and takeover by federal regulators. To date, a split of opinion exists in the United States Courts of Appeals as to the viability of this type of action when, under state law, the S&L itself could not have maintained such an action because of state law defenses that could have been asserted by the professional against the S&L.

In June of 1992, in *Federal Deposit Insurance Corporation v. O'Melveny & Meyers*,[18] the United States Court of Appeals for the Ninth Circuit reversed and remanded the district court's grant of O'Melveny & Meyers' motion for summary judgment, holding that the FDIC could maintain such an action. In *O'Melveny*, the defendant law firm argued that the fraud of the S&L's officers and directors should be imputed to the S&L, and therefore, just as the S&L would not be able to recover as a result of its own wrongdoing, the FDIC, as conservator of the S&L, should likewise be prevented from seeking recovery. The court of appeals held that, because the acts of the officers and directors were not attributable to the S&L, the defense of unclean hands could not have been asserted against the S&L itself, and therefore, it could not be asserted against the FDIC as conservator of the S&L.[19] In addition, and most importantly for purposes of this Note, the court went on to state in dicta that, even if the acts were attributable to the S&L, the FDIC enjoyed a special status in this type of litigation and was not subject to the same state law defenses as the S&L.[20]

Ignoring the *O'Melveny* opinion, in August of 1992 the United States Court of Appeals for the Fifth Circuit in *Federal Deposit Insurance Corporation v. Ernst & Young*[21] affirmed the district court's grant of the defendant accounting firm's motion for summary judgment, holding that the FDIC could not maintain such a malpractice action. The FDIC argued, among other things,[22] that the FDIC should be entitled to special protection from valid state law defenses.[23] Contrary to the special-status dicta in *O'Melveny*, the Fifth Circuit held there were no statutory or other grounds upon which to treat the FDIC differently than any other receiver or conservator under state law.[24]

The losing parties in both cases petitioned for a rehearing en banc. On October 1, 1992, the Fifth Circuit denied the FDIC's motion in the *Ernst & Young* case.[25] On September 27, 1993, while continuing to await the Ninth Circuit's ruling on their petition for rehearing en banc, O'Melveny & Meyers

---

18. 969 F.2d 744 (9th Cir. 1992), *cert. granted*, 114 S. Ct. 543 (Nov. 29, 1993).
19. *Id.* at 750-51.
20. *Id.* at 751-52.
21. 967 F.2d 166, 172 (5th Cir. 1992), *reh'g denied*, 976 F.2d 732 (5th Cir. 1992).
22. *See infra* note 105.
23. 967 F.2d at 169.
24. *Id.* at 170.
25. FDIC v. Ernst & Young, 976 F.2d 732 (5th Cir. 1992).

petitioned the United States Supreme Court for certiorari.[26] The Supreme Court granted O'Melveny's petition for certiorari on November 29, 1993.[27]

In November 1992, the FDIC and Ernst & Young reached a settlement wherein Ernst & Young paid 400 million dollars to federal regulators to settle potential claims arising out of Ernst & Young's representation of over 300 failed S&Ls.[28] The settlement included the above-mentioned litigation in the Fifth Circuit.[29] Later, in an attempt to do what has been referred to as "erase unfavorable case history," the FDIC in the *Ernst & Young* case petitioned the Fifth Circuit to have both the appellate decision and the district court decision vacated.[30] In January 1993, the Fifth Circuit denied the FDIC's motion to vacate without comment.[31]

The resolution of this issue is crucial to both regulators and professionals because the ability to sustain or thwart a motion for summary judgment in complex and costly banking cases often decides the outcome.[32] As evidenced by the flurry of activity that followed both decisions, neither the FDIC, O'Melveny & Meyers, nor professionals in general,[33] are likely to allow this issue to rest until it is decided by the United States Supreme Court. In fact, one banking industry lawyer noted that the *O'Melveny* case "could be settled for a relatively small sum believed to be less than $1 million," but O'Melveny refuses to settle and continues to fight the Ninth Circuit's decision because of the important legal issues involved.[34]

Although these cases raise other highly-debated issues,[35] this Note focuses only on the issue of whether federal courts should fashion uniform federal common law or adopt the law of the state as the rule of decision to

---

26. FDIC v. O'Melveny's & Meyers, 969 F.2d 744 (9th Cir. 1992), *cert. granted*, 114 S. Ct. 543 (Nov. 29, 1993).

27. *Id.*

28. Susan Schmidt, *Ernst & Young Pays $400 Million to Settle Thrift Regulators' Claims*, WASH. POST, Nov. 24, 1992, at A1.

29. *See* Edward Brodsky, *Accountant's Liability: Erasing History*, N.Y. L.J., Mar. 11, 1993, at 3.

30. *Id.*

31. *Fifth Circuit Panel Decides to Retain Ruling on Accountant Liability at Thrifts and Banks*, THRIFT ACCT., Feb. 1, 1993, at 3.

32. Sherry R. Sontag, *Circuits Split on Regulators' Malpractice Claims*, NAT'L L.J., Aug. 17, 1992, at 17. It has been suggested that one of the government's strategies in these cases is to "pull professionals into huge litigations with large damage demands in which slugging it out on the facts becomes too expensive to defend," forcing the defendant professionals to settle. *Id.* at 24.

33. A number of amicus briefs were filed by professionals, including one by Ernst & Young, in support of O'Melveny & Meyers' petition for rehearing. *Id.* at 17. In addition, a number of amicus briefs were filed in opposition to the FDIC's motion to vacate the *Ernst & Young* decision. Brodsky, *supra* note 29, at 3.

34. THRIFT ACCT., *supra* note 31, at 3 (referring to the comments of Arthur W. Leibold, Jr., a partner in the Washington law firm of Dechert, Price & Rhoads).

35. *See infra* notes 85-86 and accompanying text.

determine the availability of defenses against the FDIC. The FDIC argues that, regardless of whether the failed S&L could have brought the action against the professional on its own behalf, the FDIC should be afforded special protection from defenses that could have been asserted against the failed S&L under state law.[36] This argument is not consistent with the law in a majority of states. The FDIC is technically an assignee of the S&L, and in most states an assignee obtains only the right, title, and interest of the assignor at the time of his assignment, and no more.[37] Thus, under state law the assignee may recover only those damages which would have been recoverable by the assignor. Under the FDIC's argument, the FDIC becomes a "super-receiver," impervious to state law defenses that could have been asserted against the failed S&L.[38] There are no federal statutes which command such a result. The issue, then, is whether it is proper for a federal court to fashion and apply federal common law contrary to otherwise valid state law.

This Note discusses the split of opinion that currently exists between the Fifth and Ninth Circuits with regard to the federal common law issue and argues that the Fifth Circuit's statement that "[n]o statutory justification or public policy exists to treat the FDIC differently from other assignees"[39] when it acts as a receiver for a failed S&L is the conclusion mandated by decisions of the United States Supreme Court. Part I provides background on federal deposit insurance and federal regulation of the S&L industry. Part II describes the FDIC's role when confronted with a failing or failed S&L. Part III analyzes the Ninth Circuit's opinion in *O'Melveny & Meyers*. Part IV analyzes the Fifth Circuit's opinion in *Ernst & Young*. Part V reviews the current state of federal common law as evidenced by recent Supreme Court opinions. Part VI analyzes the facts of cases like *O'Melveny & Meyers* and *Ernst & Young* in light of the current state of federal common law. Part VII concludes that, in accord with Supreme Court precedent, state law should be incorporated as the federal rule of decision when determining the availability of defenses against the FDIC in litigation against professionals.

I. BACKGROUND

Savings associations began to appear in the United States in the late 1920's and early 1930's as institutions primarily devoted to residential financing.[40] Prior to the Great Depression, savings associations were

---

36. Sontag, *supra* note 32, at 17.

37. *E.g.*, State Fidelity Mortgage v. Varner, 740 S.W.2d 477, 480 (Tex. Ct. App. 1987); Allen v. Ramsay, 4 Cal. Rptr. 575 (Cal. Dist. Ct. App. 1960); Shirley v. Lake Butler Corp., 123 So.2d 267, 270 (Fla. Dist. Ct. App. 1960).

38. Sontag, *supra* note 32, at 17.

39. FDIC v. Ernst & Young, 967 F.2d 166, 170 (5th Cir. 1992).

40. Goldwasser, *The Liability Ramifications of the S&L Crisis*, 60 CPA J. 20, 22 (1990).

chartered, regulated, and monitored by state authorities.[41] In 1933, in an effort to help lift the nation out of the Great Depression,[42] Congress created the FDIC to insure the deposits of commercial banks.[43] In 1934, Congress established the Federal Savings and Loan Insurance Corporation (FSLIC) to insure the deposits of federal and state chartered savings associations.[44]

The S&L industry remained a stable, profitable industry from its advent through the late 1960's.[45] Since then, the industry went through a cycle of regulation (in the late 1960's), deregulation (in the early 1980's), and finally collapse (in the late 1980's).[46] Commonly cited causes of the industry collapse include inflation and the corresponding rising interest rates that existed in the 1970's;[47] the extensive deregulation of the S&L industry during the 1980's;[48] inadequate regulatory supervision by state and federal regulators;[49] the severe economic downturn in the southwest;[50] incompetent management of S&L's; and fraudulent conduct of S&L managers.[51]

In January of 1988, the severity of the S&L crisis motivated President George Bush to announce just eighteen days after his inauguration a comprehensive plan to resolve the crisis.[52] The result was the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA).[53] FIRREA

---

41. Paul T. Clark et al., *Regulation of Savings Associations Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989*, 45 BUS. LAW. 1013, 1017 (1990).

42. In the early 1930's the supply of money had contracted drastically due in large part to numerous bank failures. In establishing the FDIC, Congress sought to restore the public's confidence in the nation's banks. Michael B. Burgee, *Purchase and Assumption Transactions and the Federal Deposit Insurance Act*, 14 FORUM 1146, 1146 (1979).

43. *Id.* at 1146. Congress created the FDIC as part of the Banking Act of 1933 by Act of June 16, 1933, ch. 89, § 8, 48 Stat. 162, 168 (codified as amended at 12 U.S.C. §§ 1811-32).

44. National Housing Act, Pub. L. No. 73-479, § 401, 48 Stat. 1246, 1255-56 (1934). The FSLIC was created shortly after the FDIC for fear that savings association depositors might withdraw their uninsured deposits from savings associations and deposit them in federally insured commercial banks. Paul T. Clark et al., *supra* note 41, at 1018.

45. Paul T. Clark et al., *supra* note 41, at 1019; *see* Roberts & Cohen, *Villains of the S&L Crisis*, U.S. NEWS & WORLD REP., Oct. 1, 1990, at 53, 54.

46. Roberts & Cohen, *supra* note 45, at 54.

47. H.R. REP. NO. 54, 101st Cong., 1st Sess. 294 (1989).

48. *Id.* at 301. *But see* Melanie S. Tammen, *The Savings & Loan Crisis: Which Train Derailed—Deregulation or Deposit Insurance?*, 6 J. L. & POL. 311 (1990) (arguing that the collapse of the S&L industry is more a result of the nature of deposit insurance itself and political *faux pas*, than of deregulation).

49. H.R. REP. NO. 54, *supra* note 47.

50. *Id.*

51. *Id.* at 296-300. For a summary of the history of the S&L crisis see Note, *Are the Accountants Accountable? Auditor Liability in the Savings and Loan Crisis*, 25 IND. L. REV. 475, 477-83 (1991); Paul T. Clark et al., *supra* note 41, at 1013.

52. Richard E. Flint, *What D'Oench, Duhme? An Economic, Legal, and Philosophical Critique of a Failed Bank Policy*, 26 VAL. U. L. REV. 465, 466 n.13 (1992).

53. Pub. L. No. 101-73, 103 Stat. 183 (1989) (codified as amended in various sections

dramatically changed the regulatory scheme governing the S&L industry.[54] The Federal Home Loan Bank Board (Bank Board) was abolished,[55] and the newly created Office of Thrift Supervision (OTS)[56] replaced the Bank Board as the agency responsible for the regulation of the S&L industry.[57] The Resolution Trust Corporation (RTC) was established to replace the FSLIC as the agency responsible for resolving failed thrifts.[58] The FDIC succeeded the FSLIC in the FSLIC's other capacities, including the FSLIC's capacity as plaintiff in S&L crisis-related litigation.[59]

II. FDIC'S ROLE IN RESOLVING FAILED THRIFTS

Before going further, it is important to understand the FDIC's role in resolving a failed or failing S&L. It has power in its corporate capacity as insurer of S&L deposits ("FDIC/Corporate"),[60] and it has power in its receiver capacity for a failed S&L ("FDIC/Receiver").[61]

When an S&L's failure appears imminent, the FDIC has two options. First, FDIC/Corporate may directly assist the S&L through loans, deposits, or contributions; by purchasing S&L assets; or by assuming liabilities of the failing S&L.[62] Second, the FDIC may be appointed as conservator or receiv-

---

throughout 12 U.S.C.).

54. For an extensive discussion of FIRREA, see Paul T. Clark et al., *supra* note 41, at 1013; Daniel B. Gail & Joseph J. Norton, *A Decade's Journey from "Deregulation" to "Supervisory Regulation": The Financial Institutions Reform, Recovery, and Enforcement Act of 1989*, 45 BUS. LAW. 1103 (1990).

55. Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, § 703, 103 Stat. 183, 415 (1989) (repealed 12 U.S.C. § 1437).

56. Pub. L. No. 101-73, § 301, 103 Stat. 183, 278 (1989) (codified as amended at 12 U.S.C. § 1462a).

57. Pub. L. No. 101-73, § 301, 103 Stat. 183, 280 (1989) (codified as amended at 12 U.S.C. § 1463).

58. Pub. L. No. 101-73, § 511, 103 Stat. 183, 394 (1989) (codified as amended at 12 U.S.C. § 1441b).

59. *See* 12 U.S.C. § 1441a (1989 & Supp. 1993).

60. For example, such powers include the authority to invest funds held in the Bank Insurance Fund and the Savings Association Insurance Fund, the ability to assist failing institutions, and the ability to purchase assets of failed institutions. *See* 12 U.S.C. § 1823 (1989 & Supp. 1993).

61. 12 U.S.C. § 1821(c) (1989 & Supp. 1993). *See infra* note 63.

62. 12 U.S.C. § 1823(c) (1989 & Supp. 1993).

er[63] of the failing S&L[64] with powers necessary to carry out its duties as conservator or receiver.[65]

Once appointed, FDIC/Receiver has several alternatives in resolving a failed S&L, including: (1) a "deposit payoff" or liquidation where the bank is closed and depositors are paid an amount equal to their deposits up to a maximum of $100,000 per account out of the insurance fund;[66] or (2) a "purchase and assumption" (P&A) transaction where the FDIC arranges the sale of the failed banks "acceptable" assets to another solvent bank.[67] Before proceeding with its chosen method of resultion, the FDIC has a statutory obligation to determine which method will be "the least costly to the deposit insurance fund of all possible methods [of resolution]."[68]

A P&A transaction involves the sale of certain acceptable assets by FDIC/Receiver to a sound, insured bank.[69] The assets not sold to the assuming bank (i.e., the unacceptable assets) are sold by FDIC/Receiver to FDIC/Corporate.[70] A P&A transaction is usually the most desirable alternative for several reasons.[71] A P&A transaction minimizes deterioration of

---

63. The powers of the FDIC as conservator are somewhat different than those as receiver. As conservator, the FDIC has the power to take such action as may be necessary to put the S&L in a solvent condition appropriate for carrying on the business of the S&L. 12 U.S.C. § 1821(d)(2)(D) (1989). As receiver, the FDIC has the power to liquidate the failed S&L and proceed to realize upon its assets. *Id.* § 1821(d)(2)(E) (Supp. 1993). However, because as both conservator and receiver the FDIC succeeds to "all rights, titles, powers, and privileges of the insured institution", *Id.* § 1821(d)(2)(A), for purposes of this Note no distinction is made between the FDIC as conservator or the FDIC as receiver.

64. 12 U.S.C. § 1821(c) (1989 & Supp. 1993).

65. 12 U.S.C. § 1821(d) (1989 & Supp. 1993).

66. *Id.*

67. 12 U.S.C. § 1823(c)(2) (1989).

68. 12 U.S.C. § 1823(c)(4)(A) (Supp. 1993). This section states in its entirety:

> Notwithstanding any other provision of this chapter, the Corporation may not exercise any authority under this subsection or subsection (d), (f), (h), (i), or (k) of this section with respect to any insured depository institution unless—
>
> (i) the Corporation determines that the exercise of such authority is necessary to meet the obligation of the Corporation to provide insurance coverage for the insured deposits in such institution; and
>
> (ii) the total amount of the expenditures by the Corporation and obligations incurred by the Corporation (including any immediate and long-term obligation of the Corporation and any direct or contingent liability for future payment by the Corporation) in connection with the exercise of any such authority with respect to such institution is the least costly to the deposit insurance fund of all possible methods for meeting the Corporation's obligation under this section.

For a discussion of the FDIC's obligation under this section see FDIC v. Jenkins, 888 F.2d 1537, 1540 (11th Cir. 1989).

69. *Id.* at 1154.

70. *Id.* at 1155.

71. *Jenkins*, 888 F.2d at 1540. For a more detailed discussion of purchase and assumption transactions see Burgee, *supra* note 42, at 1146.

public confidence in the banking system because the failed S&L stays open.[72] Keeping the failed S&L open also avoids disruption to other solvent banks in the area which may result from the closing of a failed S&L, depending upon the extent of the "inter-bank relationships" that exist at the time of the closing.[73] Further, a liquidation may cause depositors to wait several months before they can recover the insured portion of their deposits.[74]

Once appointed receiver for a failed S&L, under 12 U.S.C. section 1821(d)(2)(A), FDIC/Receiver succeeds to "all rights, titles, powers, and privileges of the insured depository institution, and of any stockholder, member, accountholder, depositor, officer, or director of such institution with respect to the institution and the assets of the institution."[75] FDIC/Receiver has the power to "realize upon" these assets prior to their sale to FDIC/Corporate in a P&A transaction.[76] With respect to the assets sold to FDIC/Corporate in a P&A transaction, 12 U.S.C. section 1823(d)(3)(A) gives FDIC/Corporate the same "rights, powers, privileges, and authorities" as possessed by FDIC/Receiver.[77] Any amounts recovered by either the FDIC/Receiver or FDIC/Corporate are used to replenish the deposit insurance fund.[78]

The litigation examined in this Note arises when the FDIC is appointed receiver of a failed S&L and attempts to realize upon the failed S&L's assets. In this role, the FDIC endeavors to realize upon the failed S&L's assets to the maximum extent possible in order to minimize the loss to the deposit insurance fund it administers.[79] The FDIC's litigation against professionals is a means to minimizing the loss to the deposit insurance fund.

III. THE *O'MELVENY & MEYERS* CASE

In February of 1986, the FDIC stepped in as conservator for the American Diversified Savings Bank (ADSB), having determined that ADSB was insolvent.[80] ADSB had incurred substantial losses, violated laws and regulations, and operated the S&L using unsafe and unsound business practices. In its conservatorship capacity, the FDIC sued the law firm of O'Melveny & Meyers for professional negligence, negligent misrepresentation, and breach of

---

72. Burgee, *supra* note 42, at 1156.
73. *Id.* at 1153.
74. *Id.*
75. 12 U.S.C. § 1821(d)(2)(A)(i) (1989).
76. 12 U.S.C. § 1821(d)(2)(E) (Supp. 1993).
77. 12 U.S.C. § 1823(d)(3)(A).
78. Burgee, *supra* note 42, at 1155.
79. Linda D. Fox, Note, *The FDIC's Preemptive Power in Actions Against Insiders of Insolvent Financial Institutions: A Matter of Priority*, 28 CAL. W. L. REV. 147, 153 (1991/1992). *See* FDIC v. Jenkins, 888 F.2d 1537, 1546 (11th Cir. 1989).
80. FDIC v. O'Melveny & Meyers, 969 F.2d 744, 747 (9th Cir. 1992), *cert. granted*, 114 S. Ct. 543 (Nov. 29, 1993).

fiduciary duty based on work O'Melveny had performed on a private placement for ADSB. The parties agreed on the facts and tested their legal theories on cross-motions for summary judgment. The parties stipulated that certain officers and directors of ADSB, including the chairman of the board and chief executive officer, and the president, "had intentionally and fraudulently overvalued ADSB's assets, engaged in the sham sale of assets in order to create 'profits,' and generally 'cook[ed] the books.'"[81]

In defense to the FDIC's claims O'Melveny argued that

> (1) it owed no duty to ADSB or its affiliates to ferret out ADSB's own fraud; (2) the conduct of ADSB's wrongdoing officers must be imputed to ADSB, and that FDIC, as receiver,[82] stood in the shoes of ADSB; (3) and that therefore, as an ordinary assignee, FDIC was barred from pursuing any claims against O'Melveny.[83]

The United States District Court for the Central District of California granted O'Melveny's motion for summary judgment, simply stating it perceived no genuine issue of material fact.[84] On appeal by the FDIC, the Ninth Circuit held that (1) O'Melveny did owe a duty of care to its client ADSB,[85] (2) the wrongdoing of ADSB officers and directors should not have been imputed to ADSB,[86] and (3) even if such wrongdoing was imputed to ADSB, the FDIC

---

81. *Id.* at 746. Prior to the instigation of the action against O'Melveny, the FDIC filed suit against Ranbir Sahni, ADSB's chairman of the board and chief executive officer, for breach of fiduciary duty and RICO violations and against Lester Day, ADSB's president, for breach of fiduciary duty. *Id.* at 747.

82. The FDIC was actually acting as conservator. *See id.*

83. *O'Melveny & Meyers*, 969 F.2d at 747.

84. *Id.* at 747, 752.

85. *Id.* at 748-49. The standard of care owed by professionals and to whom the duty is owed is beyond the scope of this Note. Suffice it to say that several recent, well-publicized cases have upset long-held understandings about the scope of professional liability. McCoy, *supra* note 4, at 4-12; *see also* Goldberg, *supra* note 4, at 52 (The law firm of Kaye, Scholer, Fierman, Hays & Handler engaged Yale School of Law ethics Professor Geoffrey C. Hazzard, Jr. to issue an opinion in regard to their conduct in the representation of the failed Lincoln Savings and Loan. The OTS brought a $275 million law suit against Kaye Scholer for this conduct and for which Kaye Scholer eventually settled with OTS out of court for $41 million. Professor Hazzard's opinion was "that Kaye Scholer had acted exactly as it should have in a situation that was clearly a prelude to litigation."). *Id.* In part, because courts have been increasingly willing to accept regulators' arguments extending liability to S&L industry professionals, the defense battleground has begun to shift to other issues such as those proffered by the defendants in *O'Melveny & Meyers* and *Ernst & Young*. McCoy, *supra* note 4, at 12.

86. *O'Melveny & Meyers*, 969 F.2d at 749-51. Whether the officers' wrongdoing should be imputed to the corporation depends upon whether the court finds the officers' actions were done for the benefit of the corporation. 11 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 819 (perm. ed. rev. vol. 1986). The Ninth and Fifth Circuits also split as to whether the actions of the officers, which were similar in each case, were conducted for the benefit of the corporation. *See* FDIC v. Ernst & Young,

as successor in interest to ADSB was not estopped from pursuing its claims against O'Melveny.[87]

The Ninth Circuit did not dispute O'Melveny's argument and the district court's finding that under well-established California law, a receiver occupies the same position as the party for whom it acts and any defense which is good against the original party is good against the receiver.[88] However, the Ninth Circuit stated, "The flaw in this argument is the law O'Melveny assumes applies. It is by now clear beyond doubt that federal, not state, law governs the application of defenses against the FDIC."[89] The court then stated:

> While we *may* incorporate state law to provide the federal rule of decision, we are not bound to do so. *See FDIC v. New Hampshire Ins. Co.*, 953 F.2d 478, 481 (9th Cir. 1991), *amended*, 953 F.2d 478 (9th Cir. 1992). Thus, contrary to O'Melveny's argument, we are not bound by state law, but *must* instead establish federal law.[90]

With the state law slate wiped clean, the court went on to fashion uniform federal common law as the rule of decision by "adjust[ing] the equities" between the parties.[91] The court concluded that because the FDIC was not a voluntary assignee, and because the FDIC took assignment amidst "an intricate regulatory scheme designed to protect the interests of third parties who also were not privy to the bank's inequitable conduct," the FDIC should be afforded special protection from otherwise valid state law defenses.[92]

The court's statement that federal, not state, law applies to the availability of defenses against the FDIC is not disputed. When the rights and obligations of the FDIC are implicated, it is settled that federal law governs.[93] The portion of the court's opinion that has caused the split between the circuits is its statement that it "*may* incorporate state law to provide the federal rule of

---

967 F.2d 166, 171 (5th Cir. 1992); *O'Melveny & Meyers*, 969 F.2d at 750-51.

87. *O'Melveny & Meyers*, 969 F.2d at 751-52.

88. *Id.* at 751 (quoting Allen v. Ramsay, 4 Cal. Rptr. 575 (Cal. Dist. Ct. App. 1960)).

89. *Id.* (citing D'Oench, Duhme & Co. v. FDIC, 315 U.S. 447, 456 (1942); FDIC v. Bank of San Francisco, 817 F.2d 1395, 1398 (9th Cir. 1987); FDIC v. Mmahat, 907 F.2d 546, 550 (5th Cir. 1990), *cert. denied*, 111 S. Ct. 1387 (1991); FDIC v. Gulf Life Ins. Co., 737 F.2d 1513, 1517 (11th Cir. 1984)).

90. *Id.* (emphasis added).

91. *Id.*

92. *Id.* at 751-52. In fashioning this federal rule of decision by "adjusting the equities" between the FDIC and O'Melveny, the court cited two United States Supreme Court cases from the 1800's. *Id.* at 751.

93. *E.g.*, Gunter v. Hutcheson, 674 F.2d 862, 869 (11th Cir. 1982); *see also* Kamen v. Kemper Fin. Serv., Inc., 111 S. Ct. 1711, 1717 (1991) ("Because the ICA [Investment Company Act of 1940] is a federal statute, any common law rule necessary to effectuate a private cause of action under that statute is necessarily federal in character.") (citations omitted).

decision," but that it is "not bound to do so."[94] For this proposition the court cited one of its prior decisions regarding the federal common law issue,[95] but did not cite to either of the two leading United States Supreme Court cases on the issue: *Kamen v. Kemper Financial Services*[96] and *United States v. Kimbell Foods, Inc.*[97] In *Kamen*, the Supreme Court indicated there is "a presumption that state law should be incorporated into federal common law," and that federal courts should only "fill the interstices of federal remedial schemes with uniform federal rules" in certain limited situations.[98] The Ninth Circuit did not consider the issue of incorporation of state law as the federal rule of decision in accord with Supreme Court precedent on the issue. Rather, the court apparently felt at liberty to fashion federal common law as the rule of decision. The degree to which a federal court has such liberty is the issue.[99]

IV. THE *ERNST & YOUNG* CASE

The FDIC was "riding high" on its victory in *O'Melveny* for only a short period of time.[100] Two months later, in August of 1992, the Fifth Circuit ignored the *O'Melveny* decision and ruled in favor of the defendant accounting firm in a similar action, *Federal Deposit Insurance Corporation v. Ernst & Young*.[101]

In 1984, Western Savings Association's (Western's) financial condition was deteriorating as a result of numerous statutory and regulatory violations. The Bank Board stepped in and issued a temporary order for Western to cease and desist its improper business practices. In accordance with the order, Western engaged Arthur Young & Company to conduct audits for the calendar years 1984 and 1985. Arthur Young & Company's certified audits showed Western had a net worth of 41 million dollars at the end of 1984 and 49 million dollars at the end of 1985. In fact, at the end of 1984 Western was insolvent by over 100 million dollars, and at the end of 1985 by over 200 million dollars.

The FSLIC was appointed receiver of Western in September of 1986. In one of the largest suits to be filed against a professional in connection with the S&L crisis, in March of 1990 the FDIC,[102] as receiver for failed Western,

---

94. *O'Melveny & Meyers*, 969 F.2d at 751.

95. The court cited FDIC v. New Hampshire Ins. Co., 953 F.2d 478, 481 (9th Cir. 1991), *amended*, 953 F.2d 478 (9th Cir. 1992).

96. 111 S. Ct. 1711 (1991).

97. 440 U.S. 715 (1979).

98. *Kamen*, 111 S. Ct. at 1717; *see infra* Part V.

99. *See infra* Part VI.

100. Sontag, *supra* note 32, at 17.

101. 967 F.2d 166 (5th Cir. 1992).

102. Under FIRREA, the FDIC succeeded the FSLIC in certain capacities, including as

filed a complaint against Ernst & Young[103] for negligence and breach of contract. The complaint alleged damages of 560 million dollars as a result of Arthur Young's audits of Western in 1984 and 1985. The United States District Court for the Northern District of Texas held that: (1) the FDIC was not entitled to special protection when it brought a tort claim against a third party as receiver for a failed S&L; (2) the wrongdoing of Western's sole owner was attributable to Western; and (3) Western did not rely on Arthur Young's audits.[104]

On appeal to the Fifth Circuit Court of Appeals, the FDIC argued, among other things,[105] that the FDIC should be entitled to special protection from state law defenses because of the federal policies underlying FIRREA and the S&L bail-out. As in *O'Melveny*, state law was contrary to the FDIC's argument.[106] Under Texas state law "[a]n assignee obtains only the right, title, and interest of his assignor at the time of his assignment, and no more."[107] The Fifth Circuit affirmed the district court's grant of Ernst & Young's motion for summary judgment, holding that "[n]o statutory justification or public policy exists to treat the FDIC differently from other assignees."[108] The Fifth Circuit stated that when the FDIC brings an action as receiver for a failed S&L against an outside accountant, the claim is "[e]ssentially . . . a client case in which a client is suing its auditor."[109]

Although the Fifth Circuit did not cite to specific Supreme Court precedent on the issue of federal common law,[110] the cases relied upon by the court for the proposition that no statutory or policy basis exists for affording the FDIC special protection appear to apply the basic analytical structure required by Supreme Court precedent. The cases cited by the court will be more fully developed in Part VI.B.

---

plaintiff in thrift-crisis litigation. *See* 12 U.S.C. § 1441a (1989 & Supp. 1993).

103. Ernst & Young is a general partnership formed in 1989 by the merger of Arthur Young & Company and Ernst & Whinney.

104. *Ernst & Young*, 967 F.2d at 172.

105. The first point the FDIC argued was that the district court erred in holding that proving reliance on the part of the defunct S&L was an essential part of the FDIC's show of causation under Texas law. Next, the FDIC argued that the knowledge of the financial condition of the S&L's principal could not have been imputed to the S&L under Texas law because the principal's actions were not for the benefit of the S&L. Finally, the FDIC proffered the argument discussed in the text. The court rejected all three. *Id.* at 169-72.

106. *See supra* note 88 and accompanying text.

107. *Ernst & Young*, 967 F.2d at 169 (quoting State Fidelity Mortgage Co. v. Varner, 740 S.W.2d 477, 480 (Tex. Ct. App. 1987), *writ denied*).

108. *Id.* at 170.

109. *Id.* at 169.

110. *See infra* notes 115-25 and accompanying text.

V. THE CURRENT STATE OF FEDERAL COMMON LAW

In 1938, Justice Brandeis proclaimed in the landmark case *Erie R.R. v. Tompkins*[111] that "There is no federal general common law."[112] However, *Erie* did not prohibit all federal common law. The same day the *Erie* opinion was announced the Court also announced its decision in *Hinderlider v. La Plata River & Cherry Creek Ditch Co.*[113] In *Hinderlider*, Justice Brandeis recognized that federal common law governed a dispute surrounding the apportionment of an interstate stream. Supreme Court decisions subsequent to *Erie* and *Hinderlider* have indeed revealed that the Court's statement in *Erie* does not prohibit all types of federal common law.[114]

The Supreme Court has developed a two-prong test for courts to follow when confronted with the federal common law issue: first, a court should ask whether the issue before it is properly subject to the exercise of federal power; second, if it is, the court should go on to determine whether, in light of the competing state and federal interests involved, it is wise as a matter of policy to adopt a federal substantive rule to govern the issue.[115]

The Court recently revisited the federal common law issue and applied this two-prong test in *Kamen v. Kemper Financial Services*.[116] In *Kamen*, the primary issue before the Court was whether a shareholder, in a shareholder's derivative suit brought under the Investment Company Act of 1940 (ICA), was required to make a pre-complaint demand on the board of directors under Rule 23.1 of the Federal Rules of Civil Procedure or whether, under the futility exception of the law of Maryland, the shareholder could proceed with the suit without making such pre-complaint demand. Rule 23.1 contemplates demand upon the board of directors in derivative actions, but does not make such a demand a requirement of derivative actions.[117] The Court began its analysis,

---

111. 304 U.S. 64, *cert. denied*, 305 U.S. 637 (1938).

112. *Id.* at 78.

113. 304 U.S. 92 (1938).

114. *See, e.g.*, Kamen v. Kemper Fin. Serv., Inc., 111 S. Ct. 1711, 1717 (1991); Boyle v. United Technologies Corp., 108 S. Ct. 2510, 2514 (1988); United States v. Kimbell Foods, 440 U.S. 715, 726-27 (1979); Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 424-27 (1964); Clearfield Trust Co. v. United States, 318 U.S. 363, 366-67 (1943); Martha A. Field, *Sources of Law: The Scope of Federal Common Law*, 99 HARV. L. REV. 883, 908-15 (1986).

115. Field, *supra* note 114, at 886 (citing the following authorities for this two-prong test: United States v. Kimball Foods, Inc., 440 U.S. 715 (1979); United States v. Little Lake Misere Land Co., 412 U.S. 580 (1973); DeSylva v. Ballentine, 351 U.S. 570 (1956); Reconstruction Fin. Corp. v. Beaver County, 328 U.S. 204 (1946); Clearfield Trust Co. v. United States, 318 U.S. 363 (1943); Friendly, *In Praise of* Erie — *and of the New Federal Common Law*, 39 N.Y.U. L. REV. 383, 410 (1964) (discussing the two-prong inquiry as applied in *Clearfield*); Mishkin, *The Variousness of "Federal Law": Competence and Discretion in the Choice of National and State Rules for Decision*, 105 U. PA. L. REV. 797, 802-04 (1957)).

116. 111 S. Ct. 1711 (1991).

117. Rule 23.1 states, "The complaint [in a shareholder's derivative action] shall . . . allege with particularity the efforts, *if any*, made by the plaintiff to obtain the action the

addressing the first prong of the two-prong test, with the statement that "[b]ecause the ICA is a federal statute, any common law rule necessary to effectuate a private cause of action under that statute is necessarily federal in character."[118] The Court, emphasizing that the test does indeed have two prongs, then stated, "It does not follow, however, that the content of such a rule must be wholly the product of a federal court's own devising."[119]

In addressing the second prong of its test, the Court continued:

> Our cases indicate that a court should endeavor to fill the interstices of federal remedial schemes with uniform federal rules only when the scheme in question evidences a distinct need for nationwide legal standards, *see, e.g., Clearfield Trust Co. v. United States*, 318 U.S. 363, 366-367, 63 S. Ct. 573, 574-575, 87 L.Ed. 838 (1943), or when express provisions in analogous statutory schemes embody congressional policy choices readily applicable to the matter at hand, *see, e.g., Boyle v. United Technologies Corp.*, 487 U.S. 500, 511-512, 108 S. Ct. 2510, 2517-2518, 101 L.Ed.2d 442 (1988); *DelCostello v. Teamsters*, 462 U.S. 151, 169-172, 103 S. Ct. 2281, 2293-2295, 76 L.Ed.2d 476 (1983).[120]

The Court, relying on its decision twelve years earlier in *United States v. Kimbell Foods, Inc.*,[121] then stated that if the facts of an individual case did not fall within one of the two general categories above, federal courts should incorporate state law as the federal rule of decision unless such state law "would frustrate the specific objectives" of the federal statutory scheme.[122]

In applying its statement of the law to the facts in *Kamen*, the Court held that the congressional intent of the ICA did not evidence a need for a uniform federal rule; that application of the demand futility exception of the law of Maryland did not frustrate the federal policy objectives behind the ICA; and that therefore, the law of the state of Maryland should be adopted as the federal rule of decision.[123]

In summary, the *Kamen* decision illustrates that federal courts are not free to reject incorporation of state law and instead fashion federal common law as the rule of decision. The effect of the Court's holding is that, after *Kamen*,

---

plaintiff desires from the directors. . . ." FED. R. CIV. P. 23.1 (emphasis added).

118. *Kamen*, 111 S. Ct. at 1717.

119. *Id.*

120. *Id.* (emphasis added).

121. 440 U.S. 715 (1979).

122. *Id.* at 728.

123. *Kamen*, 111 S. Ct. at 1717-22. The Court did not address the second situation it had indicated required the application of a federal common law rule (i.e., where there are express provisions in analogous federal statutes that embody congressional policy readily applicable to the issue at hand, *id.* at 1717). Presumably, no federal enactments existed which the parties argued were analogous to the ICA.

there is a presumption that federal courts should adopt state law as the rule of decision. In the opinion, the Court specifically referred to "[t]he presumption that state law should be incorporated into federal common law. . . ."[124] Under *Kamen*, parties who believe a federal common law rule is appropriate in a given situation can rebut this presumption in three situations: (1) when the regulatory scheme in question evidences a specific need for uniform federal rules; (2) when express provisions in analogous federal enactments evidence a congressional policy to preempt state law in the area at hand; or (3) when state law would frustrate the specific objectives of federal legislation.[125] Part VI analyzes the FDIC's claims against professionals, the federal common law issue in light of the Supreme Court's two-prong test, and the *Kamen* presumption of state law incorporation.

VI. Federal Common Law and the FDIC's Professional Malpractice Claims in Light of *Kamen*

The statutory provisions in FIRREA do not declare that a uniform federal common law rule of decision should apply to all issues arising in litigation where the FDIC is a party simply because the FDIC is a creation of federal statute; nor have courts interpreted the federal statutes to require such a result.[126] Because not all issues litigated by the FDIC are governed by uniform federal common law, the crucial question is where to draw the line between issues governed by federal common law and issues governed by state law in litigation involving the FDIC. This line marks a delicate constitutional balance between the power of the federal government and the power of the states, as well as between the power of the judiciary and the power of the legislature.[127]

Under the first prong of the Supreme Court's incorporation test, "[i]t is. . . clear beyond doubt that federal, not state, law governs the application of defenses against FDIC."[128] Because the FDIC was created by federal statute, any common law rule necessary for the enforcement of the statute is necessarily federal in character.[129] This requirement leaves the second and more difficult prong of the Supreme Court's test yet to be analyzed. In an action by the FDIC against a professional who served a failed S&L prior to its failure and takeover by federal regulators, should a federal court determining

---

124. *Id.* at 1717.

125. *See supra* notes 120-22 and accompanying text.

126. *See, e.g., infra* notes 152-71 and accompanying text.

127. *See generally* Thomas W. Merrill, *The Common Law Powers of Federal Courts*, 52 U. Chi. L. Rev. 1, 12-32 (1985); Note, *Federal Common Law and the Preemption of State Law*, 42 Rutgers L. Rev. 1067 (1990).

128. FDIC v. O'Melveny & Meyers, 969 F.2d 744, 751 (9th Cir. 1992), *cert. granted*, 114 S. Ct. 543 (Nov. 29, 1993).

129. *See* Kamen v. Kemper Fin. Servs., 111 S. Ct. 1711, 1717 (1991).

the applicability of defenses against the FDIC incorporate state law or fashion federal common law as the rule of decision?

A. The Kamen *Presumption of Incorporating State Law as the Federal Rule of Decision*

Analysis of this second prong begins with a presumption that state law should be incorporated as the rule of decision. In *Kamen*, the Court stated that this presumption is especially strong in cases where "private parties have entered legal relationships with the expectation that their rights and obligations would be governed by state-law standards."[130] In *Reconstruction Finance Corporation v. Beaver County*,[131] the Court considered the federal common law issue and the parties' expectations in the area of property law. The Court held that state law should apply because "[c]oncepts of real property are deeply rooted in state traditions, customs, habits, and laws."[132]

The conduct and requisite standard of care for professionals involved in litigation with the FDIC are also traditionally within the purview of state law. "[L]awyers are tested and licensed, or admitted, under state law. The Supreme (or highest) Court of the state is responsible for professional disciplinary matters, and both statutory and case law of the state or states spell out their duties, responsibilities and liabilities."[133] The professionals involved in litigation with the FDIC, because federal statutes did not expressly or implicitly require otherwise, expected that their rights and obligations would be governed by state law. The FDIC's argument has the effect of altering these rights and obligations after the fact. Arguably then, under *Kamen*, the FDIC must overcome a strong presumption that a federal court should incorporate state law as the rule of decision in order to obtain the special protection of federal common law from state law defenses.

Again, the Supreme Court in *Kamen* indicated three situations that could rebut this strong presumption: (1) when the regulatory scheme in question evidences a specific need for uniform federal rules; (2) when express provisions in analogous federal enactments evidence a congressional policy to preempt state law in the area at hand; or (3) when state law would frustrate the specific objectives of federal legislation.[134] If the FDIC can proffer evidence that one or more of these situations are applicable to the FDIC's position when

---

130. *Id.* (citing United States v. Kimbell Foods, Inc., 440 U.S. 715, 728-29 (1979) (commercial law); Reconstruction Fin. Corp. v. Beaver County, 328 U.S. 204, 210 (1946) (property law)).

131. 328 U.S. at 204.

132. *Id.* at 210.

133. Arthur W. Leibold, *Federal Common Law: What and Where? Civil and Criminal Liability of Officers, Directors, and Professionals: Bank & Thrift Litigation in the 1990's* (Practicing Law Institute, No. 595, Oct. 15-16, 1991).

134. *See supra* notes 120-22 and accompanying text.

it brings a malpractice action as receiver for a failed S&L against a professional, then federal common law should be fashioned by federal courts as the rule of decision. Otherwise, the *Kamen* presumption of state law governs and state law should be incorporated as the federal rule of decision.

B. Do Federal Banking Statutes Evidence a "Distinct Need for Nationwide Legal Standards"?

Courts have recognized situations where federal banking statutes have evidenced a "distinct need for nationwide legal standards."[135] In arguing for special protection in actions against S&L professionals, the FDIC cites the 1942 Supreme Court case, *D'Oench, Duhme & Co. v. Federal Deposit Insurance Corporation.*[136] *D'Oench* was the first judicial recognition of a special status for the FDIC in bank-crisis litigation.

1. D'Oench, Duhme & Co. v. Federal Deposit Insurance Corporation.—D'Oench, Duhme & Co., a securities dealer, sold a number of bonds to a bank. The bonds later went into default, and in order to prevent the bonds from being shown as delinquent on the bank's records, the bank asked D'Oench to issue the bank a promissory note. D'Oench did so, and the bank and D'Oench entered into a secret side agreement that the note would never be called.[137] After the bank's insolvency, the FDIC acquired the note and brought an enforcement action against D'Oench as the bank's receiver. D'Oench raised both the existence of a side agreement and the absence of consideration as defenses. Both defenses would have been successful under state law.[138]

In holding that D'Oench was prevented from asserting the agreement not to call the note as a defense to the FDIC's action on the note, the Court arguably fashioned a rule of federal common law.[139] At the time, no specific statutory provision addressed such agreements.[140] However, the Court held that federal policy evidenced in the Federal Reserve Act required such a result. The Court stated:

> Sec. 12B(s) of the Federal Reserve Act, 12 U.S.C. section 264(s), provides that "Whoever, for the purpose of obtaining any loan from the Corporation . . . or for the purpose of influencing in any way the action of the Corporation under this section, makes any statement,

---

135. Kamen v. Kemper Fin. Servs., 111 S. Ct. 1711, 1717 (1991).

136. 315 U.S. 447 (1942).

137. The effect of such a transaction was an overstatement of the bank's assets because it was agreed the note would never be repaid.

138. *D'Oench, Dulme & Co.*, 315 U.S. at 462 (J. Frankfurter, concurring).

139. *Id.* at 458-59. The concurring opinion of Justice Jackson explicitly asserted that the rule was an expression of federal common law. *Id.* at 471-75 (J. Jackson, concurring).

140. A statutory provision addressing such secret agreements exists today. *See* 12 U.S.C. § 1823(e) (1989); *infra* notes 147-51 and accompanying text.

> knowing it to be false, or wilfully overvalues any security, shall be punished by a fine of not more than $5,000, or by imprisonment for not more than two years, or both." Subdivision (y) of the same section provided, at the time respondent [FDIC] insured the Belleville bank, that such a state bank "with the approval of the authority having supervision" of the bank and on "certification" to respondent "by such authority" that the bank "is in solvent condition" shall "after examination by, and with the approval of" the respondent [FDIC] be entitled to insurance.[141]

The Court stated that these sections of the Federal Reserve Act evidenced a federal policy to protect the FDIC and the deposit insurance fund which it administered from "misrepresentations as to the securities or other assets in the portfolios of the banks which respondent [FDIC] insures or to which it makes loans."[142] As a result, the Court held D'Oench could not assert the validity of the side agreement as a defense to the FDIC's action on the note.[143]

Since the *D'Oench* opinion in 1942, courts have greatly expanded the *D'Oench* doctrine.[144] This expansion has been criticized by some commentators.[145] The FDIC argued to expand the special-status protection of the *D'Oench* doctrine in *O'Melveny & Meyers* and *Ernst & Young*. In order to determine whether such expansion is appropriate in these cases the interest that the Court sought to protect in *D'Oench* should be clearly identified. In *D'Oench*, the Court specifically stated that federal policy evidenced a need to protect the FDIC from "*misrepresentations* as to the securities or other assets in the portfolios of the banks."[146] In other words, the FDIC must be able to rely upon the accuracy of a bank's or S&L's records. This interest must be distinguished from another, more general, interest which could arguably be protected by *D'Oench*: the protection of the deposit insurance fund. The remainder of this Part makes this necessary distinction and identifies the specific federal interest which the Court in *D'Oench* sought to protect.

---

141. *D'Oench, Duhme & Co.*, 315 U.S. at 456-57 (footnotes omitted).

142. *Id.* at 457.

143. *Id.* at 459.

144. *E.g.*, Porras v. Petroplex Sav. Ass'n, 903 F.2d 379, 381 (5th Cir. 1990) (*D'Oench* applies to assignees of the FDIC); Bell & Murphy & Assoc., Inc. v. Interfirst Bank Gateway, 894 F.2d 750, 754-55 (5th Cir. 1990), *cert. denied*, 111 S. Ct. 244 (1990) (*D'Oench* applies to protect a bridge bank which takes over a failed bank); Beighley v. FDIC, 868 F.2d 776, 784 (5th Cir. 1989) (*D'Oench* applies even if "borrower does not intend to deceive banking authorities"); *see* Flint, *supra* note 52, at 467; *see also infra* notes 147-51 and accompanying text (discussing what is referred to as the codification of the *D'Oench* doctrine, 12 U.S.C. § 1823(e)).

145. *E.g.*, Flint *supra* note 52.

146. *D'Oench, Duhme & Co.*, 315 U.S. at 467.

In 1950 Congress appeared to codify the *D'Oench* doctrine at 12 U.S.C. section 1823(e),[147] but much debate exists concerning whether this codification expands, contracts, or eliminates its common law roots.[148] The content of this debate is beyond the scope of this Note. However, the Supreme Court has enunciated two major federal policies underlying section 1823(e), which help clarify the federal interest referenced in *D'Oench*.

In *Langley v. Federal Deposit Insurance Corporation*,[149] the Supreme Court stated:

> One purpose of section 1823(e) is *to allow federal and state bank examiners to rely on a bank's records in evaluating the worth of the bank's assets*. Such evaluations are necessary when a bank is examined for fiscal soundness by state or federal authorities, see 12 U.S.C. sections 1817(a)(2), 1820(b), and when the FDIC is deciding whether to liquidate a failed bank, see section 1821(d), or to provide financing for purchase of its assets (and assumption of its liabilities) by another bank, see sections 1823(c)(2), (c)(4)(A). The last kind of evaluation, in particular, must be made "with great speed, usually overnight, in order to preserve the going concern value of the failed bank and avoid an interruption in banking services." *Gunter v. Hutcheson*, 674 F.2d at 865. Neither the FDIC nor state banking authorities would be able to make reliable evaluations if bank records contained seemingly unqualified notes that are in fact subject to undisclosed conditions.[150]

The Court stated a second purpose of section 1823(e) was to "ensure mature consideration of unusual loan transactions by senior bank officials, and prevent fraudulent insertion of new terms, with the collusion of bank employees, when a bank appears headed for failure."[151] Like the rationale for the common law

---

147. Act of Sept. 21, 1950, ch. 967, § 2(13), 64 Stat. 889 (1950). FIRREA later amended 12 U.S.C. § 1823(e) to read:

> No agreement which tends to diminish or defeat the interest of the Corporation in any asset acquired by it under this section or section 1821 of this title, either as security for a loan or by purchase or as receiver of any insured depository institution, shall be valid against the Corporation unless such agreement- (1) is in writing,(2) was executed by the depository institution and any person claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the depository institution, (3) was approved by the board of directors of the depository institution or its loan committee, which approval shall be reflected in the minutes of said board or committee, and (4) has been, continuously, from the time of its execution, an official record of the depository institution.

12 U.S.C. § 1823(e) (1989).

148. *E.g.*, Richard E. Flint, *supra* note 52, at 466-70.

149. 484 U.S. 86 (1987).

150. *Id.* at 91-92 (emphasis added).

151. *Id.* at 92.

doctrine espoused by the Court in *D'Oench*, the Court in *Langley* believed the congressional intent behind the passage of section 1823(e) was more specific than simply protecting the deposit insurance fund.

2. Cases cited by the Fifth Circuit in Ernst & Young.—In rejecting the FDIC's argument in *Ernst & Young* for extension of the *D'Oench* doctrine, the Fifth Circuit cited three cases which also help to identify the specific federal interest at issue in the *D'Oench* line of cases: *Federal Deposit Insurance Corporation v. Cherry, Bekaert & Holland*,[152] *Federal Deposit Insurance Corporation v. Harrison*,[153] and *Federal Deposit Insurance Corporation v. Jenkins*.[154]

a. Federal Deposit Insurance Corporation v. Cherry, Bekaert & Holland

In *Cherry Bekaert*, the FDIC sued the accounting firm of Cherry, Bekaert & Holland for professional malpractice in the performance of audits.[155] The FDIC argued that Cherry Bekaert's defense of contributory negligence on the part of the bank's former officers, a valid defense under state law, should have been dismissed because of the "doctrine set forth in *D'Oench* . . . and its progeny."[156] The court stated that the scope of *D'Oench*'s special protection was limited. Further, the court stated that "like the *Jenkins*[157]court, this Court declines to speculate that Congress contemplated that negligence suits against third party defendants are a necessary part of the recovery of the insurance fund."[158] The court thus held Cherry Bekaert could assert the defense of contributory negligence against the FDIC.[159]

b. Federal Deposit Insurance Corporation v. Harrison

In *Harrison*, the Eleventh Circuit Court of Appeals considered the issue of whether the doctrine of equitable estoppel could be asserted as a defense against the FDIC's action to enforce a guaranty agreement executed by Harrison.[160] The FDIC argued, among other things, that it should be afforded special protection against this defense. In response, the court stated the special protection of the *D'Oench* doctrine should be

> afforded [to the FDIC] *only when necessary to further the policy of promoting the stability of the nation's banking system by facilitating FDIC's smooth acquisition of assets in a purchase and assumption*

---

152. 742 F. Supp. 612 (M.D. Fla. 1990).

153. 735 F.2d 408 (11th Cir. 1984).

154. 888 F.2d 1537 (11th Cir. 1989).

155. *Cherry, Bekaert & Holland*, 742 F. Supp. at 612.

156. *Id.* at 614.

157. The court was referring to FDIC v. Jenkins, 888 F.2d 1537, 1546 (11th Cir. 1989) which was also cited by the Fifth Circuit in *Ernst & Young* and is discussed *infra* at 163-67 and accompanying text.

158. *Cherry, Bekaert & Holland*, 742 F. Supp. at 614.

159. *Id.*

160. FDIC v. Harrison, 735 F.2d 408, 409-10 (11th Cir. 1984).

> *transaction.* It is essential that the Corporation be able to acquire assets of a failed bank without fear of unknown defenses that may have been valid against the bank.[161]

The court held that there was "no reason not to apply the traditional rules of equitable estoppel to the conduct of [the] FDIC."[162]

c. Federal Deposit Insurance Corporation v. Jenkins

In *Jenkins*, the FDIC had been appointed receiver of the failed Park Bank and was seeking a declaratory judgment against the bank's shareholders.[163] The bank's shareholders, in their individual capacities, filed a number of state and federal claims against several officers and directors of Park Bank, an accounting firm, and a law firm which had represented Park Bank. The FDIC later filed claims against several of the same defendants for negligence and breach of fiduciary duty, seeking 30 million dollars in damages. The issue before the court was whether the FDIC's claims were entitled to priority over the shareholders' claims. The FDIC argued that it was either entitled to priority over shareholder actions under the scheme of federal regulations or, in the alternative, that it was so entitled under a uniform federal common law rule of decision.

In rejecting the FDIC's argument, the *Jenkins* court stated that the FDIC's mission to maximize the recovery of the deposit insurance fund alone did not require a uniform federal common law rule of priority.[164] The court reasoned that the paramount issue in such a case was whether application of state law would inhibit the FDIC from performing the analysis of the bank's records necessary to make an efficient decision as to the best method in which to resolve the failed S&L.[165] The court stated:

> Of course, it would be convenient to the FDIC to have an arsenal of priorities, presumptions and defenses to maximize recovery to the insurance fund, but this does not require that courts must grant all of these tools to the FDIC in its effort to maximize deposit insurance fund recovery. Any rule fashioned must have its base on the goal of effectuating congressional policy. We are not convinced that Congress considered collections against parties such as the bank-related defendants in this case as a necessary part of the recovery to the deposit insurance fund. Any such priority over third-party lawsuits will have to come from Congress, not this Court.[166]

---

161. *Id.* at 412-13 n.6 (emphasis added) (citing Gunter v. Hutcheson, 674 F.2d 862, 870 (11th Cir. 1982), *cert. denied*, 459 U.S. 826 (1982)).

162. *Id.* at 412.

163. FDIC v. Jenkins, 888 F.2d 1537, 1538 (11th Cir. 1989).

164. *Id.* at 1546.

165. *Id.*

166. *Id.*

The court reversed the district court's decision "insofar as it created a priority for the FDIC over the claims of the shareholders."[167]

The cases cited by the Fifth Circuit in *Ernst & Young* for the proposition that the *D'Oench* doctrine is limited in scope help illustrate what federal interest is protected by *D'Oench* and its progeny. The cases focus on the importance of protecting the process by which the FDIC decides which method of resolution to pursue. Recall that once the FDIC has been appointed receiver of a failed S&L, it has several alternatives from which to choose in resolving the failed S&L.[168] Further, the FDIC has a statutory duty to determine which alternative it believes will cause the least amount of loss to the deposit insurance fund.[169] If a P&A transaction[170] is to be used to resolve the failed S&L, this determination "must be made 'with great speed, usually overnight, in order to preserve the going concern value of the failed bank and avoid an interruption in banking services.'"[171] The courts in *Cherry Bekaert*, *Harrison*, and *Jenkins* all focused on the necessity for the FDIC to be able to rely on the accuracy of the S&L's records in making this determination. Likewise, those courts all rejected the argument that the FDIC's interest in minimizing the loss to the insurance fund by itself was sufficient to require fashioning of uniform federal common law.

3. Gulf Life Insurance Co. v. Federal Deposit Insurance Company.—In *Gulf Life*, The Eleventh Circuit Court of Appeals relied on an identical rationale in holding that federal common law afforded the FDIC special protection from the valid state law defenses of waiver, estoppel, and unjust enrichment.[172] In *Gulf Life*, the FDIC was appointed receiver for two failed banks. FDIC/Corporate purchased certain assets of the failed banks from FDIC/Receiver in a P&A transaction, including two group creditor insurance policies issued by Gulf Life Insurance Company (Gulf Life). FDIC/Corporate, seeking to realize upon the assets which it had purchased, filed suit against Gulf Life for the return of one hundred percent of certain unearned insurance premiums. Gulf Life contended it was only obligated to return thirty-five percent of the unearned premiums, basing its contention on theories of waiver, estoppel, and unjust enrichment, which were apparently valid under state law. The court specifically held section 1823(e) and the *D'Oench* progeny inapplicable because Gulf Life's defenses were not based upon mutual consent.[173] However, the court nevertheless held that federal common law

---

167. *Id.*

168. *See supra* notes 66-67 and accompanying text.

169. *See supra* note 68 and accompanying text.

170. *See supra* notes 69-74 and accompanying text.

171. Langley v. FDIC, 484 U.S. 86, 91 (1987) (quoting Gunter v. Hutcheson, 674 F.2d 862, 865 (11th Cir. 1982), *cert. denied*, 459 U.S. 826 (1982)).

172. Gulf Life Ins. Co. v. FDIC, 737 F.2d 1513 (11th Cir. 1984).

173. *Id.* at 1516.

limited the defenses available against the FDIC in a situation where FDIC/Corporate obtained an asset in the course of a P&A transaction for value, in good faith, and without knowledge of the defenses.[174]

The court indicated two key reasons why the FDIC should be afforded special protection when it is taking over a failed bank. First, the court stated "decisions concerning the appropriate method of dealing with a bank failure must be made with extraordinary speed if the going concern value of the failed institution is to be preserved."[175] Requiring the FDIC to consider each bank's state law defenses would significantly hinder this process. Second, the court stated that because these defenses are not ordinarily apparent from the bank's records, the FDIC would be unable to make an informed decision as to the appropriate method of dealing with a failed bank, thereby causing larger losses to the FDIC's insurance fund.[176] Thus, although the court did fashion federal common law as the rule of decision, it clearly sought to protect the FDIC's interest in making a quick and accurate decision regarding which method of resolution to pursue, and not the FDIC's more general interest in simply protecting the deposit insurance fund.

4. There Is Not a "Distinct Need for Nationwide Legal Standards."—At first glance, a "distinct need" may seem apparent in these types of cases. Under a broad interpretation of *D'Oench* and its progeny, the federal interest justifying protection from state law defenses is simply the protection of the deposit insurance fund. Affording the FDIC special protection from state law defenses in these types of cases will undoubtedly increase the amount of recovery to the deposit insurance fund. If that general interest was recognized as a "distinct need for nationwide legal standards" under the *Kamen* analysis, then whenever the FDIC was involved in litigation where the outcome under state law would have a negative impact on the deposit insurance fund, the FDIC would be entitled to special protection under a uniform federal common law. However, if the *Erie* doctrine is to be of any substance, this general rationale cannot suffice as a reason to afford the FDIC special protection in these cases. A general need, such as protecting the deposit insurance fund, can be found in almost every federal enactment. However, federal common law is not, nor should it be, employed as the rule of decision in litigation whenever a federal enactment is involved. Federal courts must have authority to fashion federal common law, and such authority does not exist simply because there is diversity jurisdiction or a federal enactment involved. This limit on when a federal court can fashion federal common law is why the Supreme Court has required a "distinct" need be present before the presumption of state law incorporation can be rebutted and federal common law fashioned.

---

174. *Id.* at 1516-18.

175. *Id.* at 1517 (quoting Gunter v. Hutcheson, 674 F.2d 862, 869 (11th Cir. 1982), *cert. denied*, 459 U.S. 826 (1982).

176. *Id.*

The above cases do not justify such a broad interpretation of the FDIC's need. Courts' have emphasized that the FDIC must be able to rely upon the records of the bank to make quick and accurate decisions in order to fulfill its mission of stabilizing the S&L industry and minimizing the loss to the deposit insurance fund. A potential lawsuit against a third party professional is not an asset reflected on the books of an S&L at the time the FDIC is making the decision as to which method of resolution to pursue. The professionals have not engaged in intentional behavior to deceive federal regulators as to the value of assets on an S&L's books. In fact, many times the professionals are intentionally deceived by the officers and directors of the S&L. The need recognized in the *D'Oench* line of cases does not apply to situations where the FDIC is suing third party professionals for negligence.

C. Are There Express Provisions of Analogous Statutory Schemes Which Identify Congressional Intent to Preempt?

The second situation under the *Kamen* analysis which can rebut the presumption that state law should be incorporated as the rule of decision is where analogous statutory schemes exist which embody congressional policy choices readily applicable to the matter at hand.[177] The Federal Deposit Insurance Act which created the FDIC and the numerous amendments to that Act by FIRREA represent a comprehensive scheme to monitor, regulate, and insure the entire banking system in the United States. One would have a difficult time identifying any federal enactment that one could argue is analogous to the Federal Deposit Insurance Act and FIRREA.

In addition, certain provisions within this regulatory scheme (i.e., FIRREA) arguably indicate Congress did *not* intend to preempt state law in litigation by the FDIC against professionals. Sections of FIRREA do specifically enunciate a congressional intent to preempt state law in certain other areas. For example,[178] 12 U.S.C. section 1821(i)(1) states in pertinent part,

> Notwithstanding any other provision of Federal law *or the law of any State* and regardless of the method which the Corporation determines to utilize with respect to an insured depository institution in default or in danger of default, including transactions authorized under subsection (n) of this section and section 1823(c) of this title, this subsection shall govern the rights of the creditors (other than insured depositors) of such institution.[179]

---

177. *See supra* notes 120-22 and accompanying text.

178. Other examples can be found at 12 U.S.C. §§ 1821(e)(8)(E) (1989), 1821(g)(1), and 1823(f)(4)(A).

179. 12 U.S.C. § 1821(i)(1) (1989) (emphasis added).

Congress did not include such preemptive language in the sections of FIRREA which deal with the FDIC's receivership and conservatorship powers in litigation.[180]

Also, there are FIRREA provisions which specifically address liability of professionals for their representation of a failed S&L. Certain professionals can be subject to civil and criminal penalties for violations of FIRREA as an "institution-affiliated party".[181] An "institution-affiliated party" is defined as:

> (4) any independent contractor (including any attorney, appraiser, or accountant) who *knowingly* or *recklessly* participates in-
>
> (A) any violation of any law or regulation;
>
> (B) any breach of fiduciary duty; or
>
> (C) any unsafe or unsound practice,
>
> which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the insured depository institution.[182]

If Congress intended to make professionals liable for negligence without regard to whether they might be able to assert valid state law defenses, it could have simply added the word "negligently" to the above definition.[183]

The absence of a provision specifically granting the FDIC special protection and the absence of the word "negligently" from the definition of an "institution-affiliated party" arguably indicate that Congress intended the negligence of S&L related professionals to be determined in accordance with state law. This conclusion should be afforded even more weight given the circumstances which led to the enactment of FIRREA. When the magnitude of the S&L crisis became known in the late 1980's, Congress held endless hearings on the alleged causes of the debacle and the tools needed by regulators in order to restore health to the industry.[184] Given the volume of

---

180. *See* § 1821.

181. 12 U.S.C. § 1818(i)(2) (1989). An "institution-affiliated party" may be fined: (1) up to $5,000 per day for violation of any law or regulation, *id.* § 1818(i)(2)(A); (2) up to $25,000 per day for any violation of law or regulation that is a pattern of misconduct, causes or is likely to cause more than a minimal loss to the S&L, or results in a benefit to such party, *id.* § 1818(i)(2)(B); or (3) up to $1,000,000 per day for knowingly or recklessly causing substantial losses to the S&L or substantial benefits to itself. *Id.* § 1818(i)(2)(C), (D). An "institution-affiliated party" who knowingly violates an order issued by a federal regulatory agency could be subject to a criminal penalty of up to $1,000,000 and a prison term up to five years, or both. *Id.* § 1818(j).

182. *Id.* § 1813(u)(4) (emphasis added).

183. Monies collected under the penalty provisions for institution-affiliated parties are deposited into the United States Treasury and do not go to the failed S&L, *see* § 1818(i)(2)(J), and consequently, do not go to the failed S&L's depositors and creditors. Recovery by the FDIC in a negligence action, as an assignee for a failed S&L, would on the other hand go to the failed S&L, and ultimately to the S&L's depositors and creditors.

184. *E.g., Failure of Independent CPA's to Identify Fraud, Waste and Mismanagement*

hearings and deliberation that led to the passage of FIRREA, arguably, it should be assumed that Congress included within FIRREA "all the necessary tools to go after the wrongdoing that Congress thought had happened."[185] Apparently, Congress did not feel special protection from state law defenses in actions against professionals was one of the "necessary tools to go after the wrongdoing" which occurred in the demise of the S&L industry.

D. Would Incorporating State Law Frustrate Specific Objectives of Federal Banking Statutes?

The FDIC argues that by not being afforded special protection from state law defenses federal courts are hindering its efforts to accomplish one of the primary objectives of FIRREA: the protection of the deposit insurance fund. It is undoubtedly true that minimizing the loss to the deposit insurance fund is one of the primary objectives of FIRREA. However, this objective alone should not be relied on by federal courts to fashion federal common law. As stated earlier, every federal enactment has general objectives similar to the protection of the deposit insurance fund, and if these general objectives were enough to allow a federal court to fashion federal common law, the *Erie* doctrine would be all but forgotten. The Court instead requires that state law frustrate "specific" legislative objectives.

As discussed above, the only specific objective of FIRREA which courts have recognized as one that should not be frustrated by state law is the protection of the FDIC's ability to quickly and accurately conduct an analysis of a failed S&L's assets so that the failed S&L is optimally resolved. Incorporating the law of the state in these cases would not hinder the FDIC's ability to make quick and accurate decisions when it takes over as receiver for a failed S&L. The *D'Oench* doctrine and 12 U.S.C. section 1823(e) already adequately protect the FDIC's need for accuracy in S&L records. In addition, a potential lawsuit against third parties can only be viewed as a contingency at the time the FDIC is making its decision.[186] In this regard, granting the

---

and Assure Accurate Financial Position of Troubled S&L's: Hearings Before the Comm. on Banking, Finance and Urban Affairs, 101st Cong., 1st Sess., 30 (1989); *High-Yield Debt Market Junk Bonds: Hearing Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce*, 101st Cong., 2d Sess. 12, 25 (1990) (statements of Mark Backmann, Sr. Vice President, Standard & Poor's Rating Group and Thomas J. McGuire, Executive Vice President of Moody's Investors Service); *Preliminary Inquiry into Allegations Regarding Senators Cranston, DeConcini, Glenn, McCain and Reigle, and Lincoln Savings and Loan: Open Session Hearings before the Senate Select Comm. on Ethics*, 101st Cong., 2d Sess. (1991).

185. Don J. DeBenedictis, *Kaye Scholer: The Tremors Continue: The Big Freeze*, A.B.A. J., July 1992, at 58.

186. FDIC v. Jenkins, 888 F.2d 1537, 1544 (11th Cir. 1989) ("The value of a potential lawsuit against solvent third parties cannot be assessed during the quick review of a failed bank's books which occurs during a purchase and assumption transaction.").

FDIC special protection may actually have a detrimental effect on the insurance fund. When evaluating a failed S&L, the FDIC may place too much value on potential lawsuits against third parties. Thus, the decision regarding the proper resolution method may become skewed, and as a result, the FDIC would not be complying with its statutory duty to proceed in the manner which will cause the least amount of loss to the deposit insurance fund.[187]

VII. CONCLUSION

An example may help to illustrate the tremendous power the FDIC argues it has. On a Friday afternoon, the ABC S&L is represented by the XYZ law firm. The law firm was negligent in a real estate development offering which the firm handled for the S&L a few months ago. However, the officers and directors of the S&L had intentionally deceived the law firm by providing false financial information regarding the offering. On this Friday afternoon, in most states, the law firm most probably could not be sued by the S&L because it could assert a number of state law defenses such as contributory negligence, unclean hands, etc. Unfortunately for the law firm, the S&L is declared insolvent over the weekend, and the FDIC is appointed as receiver. The FDIC argues on Monday that it can file a negligence action against the law firm and that the law firm cannot now assert those same defenses it could have asserted against the S&L on Friday afternoon.

Congress could legislate to require such a result. However, Congress has not done so. Furthermore, cases like *O'Melveny & Meyers* and *Ernst & Young* fall outside the contours defined by the Supreme Court for application of federal common law fashioned by a federal court.

The Court has set forth a two-prong test for determining when a federal court should fashion federal common law in the absence of specific congressional intent. Under the first prong, when the FDIC is involved in this type of litigation, it is clear the rule of decision is federal in character. However, the Court has stated, "[I]t does not follow . . . that the content of such a rule must be wholly the product of a federal court's own devising."[188] In fact, the Court has stated a "presumption that state law should be incorporated into federal common law."[189] In addition, the Court has stated this presumption is especially strong in areas that are traditionally within the purview of state law. Professional negligence is argued as one such area, and as a result the FDIC must rebut a strong presumption of state law incorporation in order to prevail on its special protection argument. The Court has espoused specific instances where this presumption can be rebutted and a federal court may fashion federal common law, and cases like *O'Melveny & Meyers* and *Ernst*

187. *See supra* note 68 and accompanying text.
188. Kamen v. Kemper Financial Services, 111 S. Ct. 1711, 1717 (1991).
189. *Id.*

& Young are not such instances. When the Supreme Court renders its decision in the *O'Melveny & Meyers* case it should reverse the Ninth Circuit's opinion in that case, holding that state law governs the applicability of defenses against the FDIC in suits brought by the FDIC against professionals for negligence.

A Class Act: Forces of Increased Awareness, Expanded Remedies, and Procedural Strategy Converge to Combat Hostile Workplace Environments

Jan Michelsen*

Introduction

A "triple-play" of judicial rulings, legislative actions and societal changes in the fall of 1991, whether plan, coincidence or legal serendipity, set the stage for new developments and strategies in sexual harassment law. A growing awareness of and sensitivity to sexual harassment in the workplace was fueled by the fiery indignation of millions of women—and men—throughout the country who viewed the Clarence Thomas confirmation hearings, confirmed by the proliferation of claims against prominent politicians and personalities,[1] and invigorated by an awakening in and among women[2] of long suppressed or long ignored injustices[3] in the form of manipulative sexual attention in the workplace.

Against that backdrop, or perhaps because of it, came the opportune passage of the Civil Rights Act of 1991[4] which allows those harmed by sexual

---

* J.D. Candidate, 1994, Indiana University School of Law—Indianapolis; B.S., 1977, *summa cum laude*, Bradley University; M.B.A., 1987, Indiana University Graduate School of Business.

1. For example, the Senate Ethics Committee began a preliminary inquiry into sexual harassment allegations against U.S. Senator Robert Packwood of Oregon. The Committee had been under heavy pressure from women's groups and congressional leaders to investigate allegations from 10 former female staff members who accused Packwood of uninvited, unwanted sexual advances. Larry Margasak, *Packwood Inquiry Starts*, INDIANAPOLIS STAR, Dec. 2, 1992 at A-2. In the year following the initial allegations, coverage of and pressure on Packwood intensified. The number of accusers increased to two dozen, and even members of Packwood's own party called on him to resign. *Kassebaum Calls on Packwood to Resign*, LOS ANGELES TIMES, Dec. 19, 1993 at A-22, col. 1. Reactions to the Navy Tailhook scandal, where at least 26 women were manhandled by a group of Navy Aviators, included the resignation of the Secretary of the Navy and the reassignment of an admiral who ignored his aide's complaints. *Suffering in Silence No More, Women Fight Back on Sexual Harrassment*, N.Y. TIMES NATIONAL, July 14, 1992, C-17.

2. Reacting to Anita Hill's speech at a conference "Women Tell the Truth: Parody, Power and Sexual Harassment" at Hunter College in New York, women said "she absolutely inspired me to think about my own life," that it is "an issue that people have a lot of feelings about . . . a lot of us have experienced it. And Anita Hill gave us a voice." *Weekend Edition: Sexual Harassment Conference at Hunter College* (National Public Radio broadcast Apr. 26, 1992) (available in LEXIS, NEXIS library, NPR file).

3. For example, harassment dating back four centuries has been documented, as have incidents of working women being harassed in Massachusetts colonial mills. *Sex, Power and the Workplace* (PBS broadcast Jan. 15, 1993) [hereinafter *Sex, Power and the Workplace*].

4. Civil Rights Act of 1991, Pub. L. No. 102-166, 105 Stat. 1071 (1991) was approved

harassment as a form of sex discrimination to recover compensatory and punitive damages.[5] Although a hostile, sexually harassing workplace has been recognized as a form of employment discrimination for more than fifteen years,[6] relief under the Civil Rights Act of 1964 was limited to injunction and restitution for economic injuries such as loss of promotion or pay.[7] The allowance of compensatory and punitive damages by the Civil Rights Act of 1991 is likely to "up the ante" on both sides: potential claimants now have far greater incentive to bring suit,[8] and employers have far more to lose, legally and financially.[9]

The timing of such a potentially powerful remedy, coming as it did on the heels of a nationally, even internationally[10] raised consciousness with respect to the prevalence and power of sexual harassment, forms a new wrinkle in this already disheveled area of the law. While there has always existed a moral imperative to seek recompense for harassment wrongs, now there is a clear, practical remedy, one that might prove motivating enough to balance the expense, energy, and risk of humiliation required from a woman brave enough to bring such a suit.

---

by United States House of Representatives on Nov. 7, 1991 and the United States Senate on Oct. 25, 1991, signed by President George Bush on Nov. 21, 1991 [hereinafter Civil Rights Act of 1991].

5. Civil Rights Act of 1991, § 102 (S 1745), Damages in Cases of Intentional Discrimination, which amends § 1977 (42 U.S.C. 1981) by adding a new § 1977A.

6. Williams v. Saxbe, 1976 WL 605 (D.D.C. 1976) was the first case to give authority to the claim that sexual harassment violates Title VII. The Supreme Court ruled in Meritor Savings Bank FSB v. Vinson that hostile environments are a violation of Title VII if "sufficiently severe or pervasive." 477 U.S. 57, 67 (1986).

7. According to the Civil Rights Act of 1964, 706(g), 42 USC § 2000e-5(g), prevailing plaintiffs were entitled to only back pay that resulted from termination and equitable relief in terms of reinstatement or front pay. No damages were allowed for emotional distress, humiliation, and psychological damages, and no punitive damages were provided to deter future violations. CHI. DAILY L. BULL., Oct. 31, 1991, p. 3, col. 3.

8. Enhancement of damages will provide "necessary incentive for women to come forward . . . and for employers to take it seriously." Susan Deller Rose in *Thomas Hearings Illustrate Problems Inherent in Resolving Harassment Cases*, 29 GOV'T. EMPL. REL. REP. (BNA), at 1464 (Nov. 11, 1991) [hereinafter *Thomas Hearings*].

9. According to Vincent J. Apruzzese, then-chairman elect of Section on Labor and Employment Law of the American Bar Association, a "garden variety" sexual harassment case "can easily cost $100,000 to defend." *Alternative Dispute Resolution Program May Be Adopted by EEOC on Trial Basis*, 21 DAILY LAB. REP. A-15 (Jan. 3, 1992) [hereinafter *Alternative Dispute Resolution*].

10. A report of the International Labor Organization found that sexual harassment affects women throughout the industrialized world. The study found that 6-8% of working woman were forced to change jobs due to harassment, and 15-30% had experienced serious sexual harassment problems. From 21% to 74% of women in Austria, Czechoslovakia, Denmark, Germany, France, Spain, and Britain had reported experiencing sexual harassment. *Sex Harassment Occurs Worldwide, Study Finds*, INDIANAPOLIS STAR, Dec. 1, 1992, at B-5.

It was only a matter of time or, perhaps, percolation before the energy generated by this propitious convergence of forces would be released via the procedural tactic of class action certification. The first class certification of a hostile environment claim in a sexual discrimination suit came in December 1991 when Federal District Judge James Rosenbaum certified the class in *Jenson v. Eveleth Taconite Co.*[11] This case requested relief from sexual harassment for all women employees at Eveleth, a mining company, citing the hostility of sexually graphic posters, graffiti, insults and comments. Although the sexual harassment allegations were part of a broader claim of sex discrimination, the ruling was significant in that it verified the possibility of the success[12] of such a strategy and forewarned the probability of class action proliferation and power.

This double-barreled impact: greater incentive to bring suit and greater numbers of plaintiffs, geometrically increases the deterrent value of harassment litigation.[13] As such, it is of widespread importance to employers, to attorneys, to plaintiffs, and to that growing percentage of the workforce[14] who are female and, thus, most susceptible to harassment. Additionally, the public interest stirred by the Thomas-Hill hearings offers an intense, informed setting for legislative and judicial decisions regarding class action certification that could ultimately give more women a stake in such litigation and benefit more women by its outcomes. This Note will examine the legal propriety of class action certification in hostile environment sexual harassment[15] suits and the potential impact of such certification in light of the new remedies afforded by the Civil Rights Act of 1991.

After exploring the reasoning and rulings that have brought the law to this precipice in harassment litigation, this Note discusses the use of class actions in hostile environment cases; why such a procedural device is appropriate and, perhaps, long overdue; and the challenges of meeting the Rule 23[16] certifica-

---

11. 139 F.R.D. 657 (D. Minn. 1991).

12. The U.S. District Court for Minnesota later ruled that Eveleth was liable under Title VII for creating a hostile work environment for the class of female plaintiffs. Jenson v. Eveleth Taconite Co., 824 F. Supp. 847 (1993).

13. "The threat of individual suits offers little incentive to employers to avoid discrimination, while the threat of class action suits is very effective in forcing employers to eliminate even the subtlest forms of discrimination." Judith J. Johnson, *Rebuilding the Barriers: The Trend in Employment Discrimination Class Actions*, 19 COLUM. HUM. RTS. L. REV. 1, 59 (1987).

14. In 1990, women held half of all U.S. jobs. *Sex, Power and the Workplace*, *supra* note 3.

15. The Equal Employment Opportunity Commission (EEOC) definitions of harassment encompass both hostile environment and *quid pro quo* harassment. 29 C.F.R. § 1604.11 (1988) *see* 45 Fed. Reg. 25024 (1980). Since *quid pro quo* suits tend to be more individualized in terms of fact patterns, and often involve direct economic injury, this note focuses primarily on hostile environment claims. For a discussion of *quid pro quo* harassment *see* CATHARINE A. MACKINNON, SEXUAL HARASSMENT OF WORKING WOMEN 32-40 (1979).

16. Fed. R. Civ. P. 23.

tion requirements. The Note analyzes the probable and potential impact—on employers and on plaintiffs—of this tripartite force of raised consciousness, broadened remedies under Title VII, and new strategies suggested by the *Jenson* case in future hostile environment litigation and, ultimately, its impact on workplace. behavior and attitudes. This Note submits the desirability of certifying class actions as appropriate means of litigating harassment claims and suggests how certification of class actions could compel a true difference in attitude and environment that might bring us closer to meeting the goals of Title VII.[17]

While writers have discussed the potential impact of the Civil Rights Act of 1991, its allowance of damages, and possible reactions by plaintiffs, employers, and the legal system, the catalytic effect of class action certification may have heretofore been overlooked or underestimated.[18] Especially given the *Jenson* certification ruling and the court's later finding of employer liability, this potential impact should be strongly considered and assessed in light of the possibility of class action certification and the reality of liability to a class for hostile workplace environments. Since this first class certification came so soon after the expanded remedies contemplated and then offered by the 1991 Civil Rights Act, and since the legislation is too new for any of its actual impact to have been fully analyzed, the interplay of these legal forces, both conflicting and complementary, has yet to be fully explored.

I. A Triad of Socio-Legal Forces

A. Raised Consciousness, Increased Claims

Millions of Americans sat transfixed and transfigured by the Clarence Thomas confirmation hearings, over a period of thirteen days, for 83.8 hours in the fall of 1991.[19] Although sexual harassment was not a novel concept,[20] it was this multimedia event that brought it out of the offices and factories and warehouses and into the living rooms of Americans, awakening the consciousness of harassers[21] and "harassees" alike.

---

17. Pub. L. No. 88-352, §§ 701-716, 78 Stat. 241 (codified in 42 U.S.C. § 2000e to 20003-17 (1982)) [hereinafter Title VII].

18. Helen Norton, of the Women's Legal Defense Fund, reacting to the *Jenson* certification, said she doubted that such treatment would be the norm, or routine way of dealing with such cases. *Federal Judge Grants Class Action Treatment to Sex Harassment Claim Against Mining Company*, 244 Daily Lab. Rep. at A-10 (Dec. 19, 1991). Perhaps this is because the EEOC has focused solely on individual claims, at least since the Reagan administration. *Id.*

19. C-Span broadcast logs, Washington, D.C. (Sept.—Oct. 1991).

20. Over 38,500 sexual harassment cases had been filed with the EEOC since 1980. H.R. Rep. No. 102-40(I) 102d Cong., 1st Sess. 68 (1991) [hereinafter House Report].

21. Irene Natividad, Chairwoman, National Commission of Working Women, suggested that the Thomas hearings acted as a catalyst to push business to move more quickly to avert sexual

The effect has been swift and unmistakable. Since Anita Hill's dramatic testimony, formal charges of sexual harassment have climbed.[22] After these hearings, the Equal Employment Opportunity Commission (EEOC) experienced a "tidal wave" of inquiries from women about sexual harassment, and a "marked increase" in complaint filings in the months following the hearings.[23] Some courts are reporting a twenty percent rise in the number of sexual harassment lawsuits.[24] This trend could intensify, given that the increased attention being paid to the problem by both media and employers will likely make women's claims "more respectable" and eliminate some of the stigma associated with them.[25]

This rapid rate of expansion is likely to accelerate in the coming years. Most harassment that women experience has been neither reported nor litigated,[26] so the sheer volume of *potential* sexual harassment litigants is overwhelming.[27] Even if the present level of actual harassment remains

---

harassment *Morning Edition: Employers Deal with Sexual Harassment* (National Public Radio broadcast, May 7, 1992) (available in LEXIS, NEXIS library, NPR file).

22. In the year following the Hill-Thomas hearings, the EEOC reported a dramatic increase in formal charges of sexual harassment. *Id. See also* Marilyn Adams, *Sex Harassment Charges Up Sharply*, BOSTON GLOBE, July 13, 1992 at 3 (EEOC sees increase in the number of sexual harassment claims received in 1992 as compared to the same period in 1991); Jane Gross, *Suffering in Silence No More, Women Fight Back on Sexual Harassment*, NEW YORK TIMES, July 14, 1992 at C-17 (The E.E.O.C. reported that sexual harassment claims filed in the first half of fiscal year 1992 were up more than 50% from the same reporting period the year before).

23. According to John D. Schmelzer, attorney-advisor in EEOC office of program operations. *Alternative Dispute Resolution, supra* note 9, at A-15.

24. *Id.*

25. *Thomas Hearings, supra* note 8, at 1464.

26. Most women tolerate sexual harassment as a matter, not of choice, but of economic survival, "suffering in silence" despite the chronic debilitating effect of harassment. *Sex, Power and the Workplace, supra* note 3.

27. For example, 88% of the 9000 women responding to a REDBOOK survey had experienced sexual harassment. Claire Safron, *What Men Do to Women on the Job*, REDBOOK, Nov. 1976, at 149. The chairman of the House Subcommittee investigating sexual harassment in the federal government said, "[t]he problem is not only epidemic, it is pandemic, an everyday, everywhere occurrence." *Sexual Harassment in the Federal Government: Hearings Before the Subcommittee on Sexual Harassment in the Federal Government*, 96th Cong., 1st Sess. 1 (1979) (statement of Rep. Hanley). More than 42% of female federal government employees reported being harassed. *Sexual Harassment in the Federal Government: An Update* at 11, Merit Systems Protection Board (1988). Fifty-three percent of working women say they have encountered harassment. BARBARA GUTEK, SEX AND THE WORKPLACE 47-48 (1985). Studies have found that sexual harassment occurs throughout the nation, in large cities and small towns, and in a wide range of occupational settings. Jill Laurie Goodman, *Sexual Harassment: Some Observations on the Distance Travelled and the Distance Yet to Go*, 10 CAP. U. L. REV. 445, 453 (1981). Unfortunately, age, education, geography or job status does not insulate one from a hostile environment. Even among professionals, harassment is pervasive. Frances Conley, a female neurosurgeon at Stanford University, reported that she had been subject to 20 years of pervasive harassment. *See Sex, Power and the Workplace, supra* note 3. Fifty-one percent of woman lawyers reported in a recent survey that they had experienced harassment on the job. Thom

constant or even decreases, more victims choosing to come forward to report a greater percentage of incidents will have the effect of increasing litigation.

This galvanization of unprecedented public awareness was just the first step. Given the enormous disincentives to bringing suits against employers,[28] awareness—even outrage—is, by itself, not enough.

B. Meaningful Remedies: The Civil Rights Act of 1991 is Passed Into Law

The provisions for compensatory and punitive damages for Title VII violations[29] included in the Civil Rights Act of 1991 offer fuller and fairer relief to plaintiffs.[30] That the damages are limited to "cases of intentional discrimination," i.e. disparate treatment, will not insulate defendants in sexual harassment claims since such environmental harassment is by definition intentional.[31] The offensive environment created by sexual harassment does not present an elusive factual question of intentional discrimination, since "it should be clear that sexual harassment is discrimination based upon sex."[32]

To receive punitive damages, the complainant must prove discriminatory practices were implemented with malice or reckless indifference to individuals rights. Although the burden is on the plaintiff to prove this conduct, "the nature of sexual harassment . . . appears uniquely susceptible to such proof."[33]

These new remedies should be particularly attractive to hostile environment plaintiffs. In many cases of hostile environment harassment, there has been great suffering and loss[34] but no economic harm. Before 1991, no other

---

Weidlich & Charlise K. Lawrence, *Sex and the Firms: A Progress Report*, THE NATIONAL LAW JOURNAL, Dec. 20, 1993 at 1. A survey involving nearly 30,000 faculty at 270 U.S. colleges and universities revealed that one out of 7 female faculty members had experienced sexual harassment at their current institution. *Harassment: It's Academic*, USA Today, April 8-10, 1994, at 1A.

28. *See infra* notes 116-19, 205-16 and accompanying text.

29. Damages available under Title VII include compensatory damages for "future pecuniary losses, emotional pain, suffering, inconvenience, mental anguish, loss of enjoyment of life, and other non-pecuniary losses." *Computing Damages*, 131 DAILY LAB. REP. EI (July 8, 1992). Also punitive damages are available in cases where the plaintiff "demonstrates that the [employer] engaged in discriminatory practice[s] with malice or with reckless indifference to the federally protected rights of an aggrieved individual." *Id.*

30. William Kandel, *Mixed Motives, Sexual Harassment and the Civil Rights Act of 1991*, 17 EMPLOYEE REL. L.J. 636, 641 (1992).

31. In *Bundy v. Jackson* the court found that in cases of sexual harassment, the advance or insult almost always represents "an intentional assault on an individual's innermost privacy." 641 F.2d 934, 945 (D.C. Cir. 1981).

32. Jones v. Flagship Int'l., 793 F.2d 714, 720 n.5 (5th Cir. 1986), *cert. denied*, 479 U.S. 1065 (1987) (no specific prima facie case needed).

33. *See* Kandel, *supra* note 30, at 641.

34. Victims of intentional discrimination often endure humiliation, pain, suffering, psychological harm, and related medical problems which result in medical expenses and other

meaningful remedy was available because previously Title VII had provided no damages remedy to redress such violations.[35] While other kinds of discrimination wrongs often result in discharge, denial of promotion, or refusal to hire for which back pay or other equitable relief has been possible, if accompanied by constructive or actual discharge,[36] victims of hostile environments often choose to stay and suffer the stress and illness they experience.[37] Even though courts have held that economic damage is not required for a showing of sexual discrimination,[38] the limited pecuniary remedies made a legal verdict for a prevailing plaintiff a somewhat hollow personal victory. Now, the availability of compensatory and punitive damages may serve a dual purpose: as a powerful threat to those employers who may not have taken sexual harassment seriously, and as an incentive for women to more vigorously pursue their claims.

Once it is shown that an employer has violated Title VII, courts have been clear that relief due must be provided on an individualized basis to those who have suffered discrimination.[39] Where the form of illegal practice makes it difficult to reach individual determinations, as might be true in sexual harassment suits, classwide relief may be appropriate.[40] The entire amount of damages can be prorated to each victim of discrimination based on some formula. Usually this is done in the context of back pay, but now that compensatory and punitive damages are allowed, these could be distributed in a similar fashion, on the assumption that the hostile environment had minimum or equal affects on all exposed.

C. Jenson v. Eveleth Taconite, Co. *Gives Class Certification to Hostile Environment Claims*

The third and final force in this triad occurred with the 1991 class certification of a suit brought by three women alleging gender discrimination, including a hostile work environment. In *Jenson v. Eveleth Taconite Co.*,[41] the plaintiffs sued on behalf of a class of women who had applied for employment or had been employed by the company, and Judge James Rosenbaum certified the class, finding that the plaintiffs could include

---

economic loss. House Report, *supra* note 20, at 66.

35. 42 U.S.C. § 2000e-5(g). *See also* Bohen v. City of East Chicago, 799 F.2d 1180, 1184 (7th Cir. 1986).

36. Brooms v. Regal Tube Co., 881 F.2d 412 (7th Cir. 1989).

37. Testimony of Jackie Morris, who suffered nervousness, sleeplessness and breathing difficulties from harassment: "I recovered nothing for the pain, suffering and frustration that I endured for years." *See* House Report, *supra* note 20, at 66.

38. Meritor Sav. Bank FSB v. Vinson, 477 U.S. 57 (1986).

39. SUSAN M. OMILIAN AND JEAN P. KAMP, SEX BASED EMPL. DISCRIMIN. § 14.03 at 13 (1990).

40. Domingo v. New England Fish Co., 727 F.2d. 1429 (9th Cir. 1984).

41. Jenson v. Eveleth Taconite Co., 139 F.R.D. 657 (D. Minn. 1991).

harassment claims in allegations of sex bias in their employment.[42] Ultimately, the plaintiffs prevailed—in its ruling on the class action lawsuit alleging sexual harassment, the Minnesota District Court found Eveleth Taconite Co. liable for creating a hostile work environment for women.[43]

The plaintiffs in *Jenson* did not raise individual claims of harassment but argued that the systemic offenses were pervasive enough to create an "oppressive work environment."[44] Even though the defendants argued that sexual harassment claims cannot be made on a classwide basis, the judge applied the reasonable woman standard[45] in finding the requisite commonality, and refuted defendant's contention that commonality is automatically defeated by individual reaction to harassment. In *Jenson*, the court found "while the factual patterns experienced by individual women are inevitably distinct, they give rise to a common question of law—whether or not Eveleth Mines discriminated against women."[46] The *Jenson* court shifted emphasis to the *result* of the hostile behavior, away from the *reaction* to it. Specifically, the court chose to define the common questions of law as whether discrimination in the form of a hostile environment occurred (the behavior of the defendant) and not whether or how an employee reacted to that discrimination (reaction of the plaintiff). This reasoning offers a logic and a precedent that could allow other such actions to meet the oft-disputed commonality requirement.

Also significant is the court's decision to include all of the claims, since it could have chosen to certify the class absent the harassment claims.[47] Such an approach, to isolate and then deny certification of the harassment claim, has been used previously to prevent sexual harassment class actions.[48] Since the *Jenson* plaintiffs were subjected to whatever conditions existed in the mines, they could fairly include claims for harassment of other employees.[49] The court inferred that all woman workers were subject to a hostile work environment and that this fact connected persons otherwise differently situated.[50]

In *Jenson*, the court pointed out that the women "advance[d] the view that incidents of sexual harassment constitute but one facet of their discrimination

---

42. *Id.*

43. Jenson v. Eveleth Taconite Co., 824 F. Supp. 847 (D. Minn. 1993).

44. Evidence included sexually explicit graffiti, posters everywhere (including locked company bulletin boards, restrooms, and elevators) and offensive language, both specific and generic. *Id.* at 663, n.20.

45. *See infra* notes 67, 98, 144 and accompanying text.

46. *Jenson*, 139 F.R.D. at 665.

47. Class may be certified as to one or more claims without certifying the entire complaint. FED. R. CIV. P. 23(c)(4).

48. UAW v. LTV Aerospace and Defense Co., 136 F.R.D. 113, 130 (N.D. Tex. 1991).

49. *Jenson*, 139 F.R.D. at 663.

50. *Id.*

claims." They did not seek damages based on individual incidents of harassment but requested class-wide injunction, declaratory and financial relief.[51]

II. A Powerful Convergence of Forces

Taken alone, it is probable that each of these forces would have had some impact, however inestimable, on the volume and intensity of sexual harassment litigation: greater numbers of plaintiffs likely to come forward—more aware, more encouraged, or more motivated by the promise of adequate remedies. Taken together, the impact may be geometric rather than additive in effect. Given increased awareness and the incentive of meaningful remedies, that hostile environment claims can now be litigated on a class-wide basis suggests they are a force to be reckoned with.[52]

A. Of Pin-ups and Profanity: Offensive Workplace Environments

Before analyzing the combined effect of awareness, available damages, and the opportunity for class action treatment in hostile environment suits, it is useful to briefly examine the state of sexual harassment law as it relates to those claims. The concept itself did not even come into popular use until the mid 1970s.[53] Since the Supreme Court's ruling in *Meritor Savings Bank v. Vinson*,[54] sexual harassment has been recognized as a form of sex discrimination under Title VII.[55] Moreover, a hostile environment, even absent tangible

---

51. *Id.* at 662. In its ruling, the district court explained that hostile environment class actions differ from usual pattern and practice cases: in the latter, a determination of discriminatory pattern or practice entitles individual members to a presumption of discrimination against him or her, and the burden shifts to the employer to rebut that presumption. In contrast, individual harassment claimants are entitled only to the presumption that the conduct was unwelcome, that the environment was hostile—each must then show she was as affected as a reasonable woman would be before the burden shifts. Thus, individual proof is required for recovery. *Employment Discrimination*, 61 U.S.L.W. 2696, May 25, 1993 (dicussing *Jensen* decision). In order to qualify for individual remedy, each class member must prove by a preponderance of the evidence that she was as affected as a "reasonable woman" would have been by the harassment. *Id.*

52. *See* Johnson, *supra* note 13.

53. Catharine McKinnon is credited with popularizing the term in her book, Sexual Harassment of Working Women. *See* MacKinnon, *supra* note 15, at 27-28 n.13 (referring to the term's use in In re Carmita Wood, App. No. 207, 958, New York State Department of Labor, Unemployment Insurance Division Appeal Board (Oct. 6, 1975) and in Carroll Brodsky, The Harassed Worker 27-28 (1976)).

54. 477 U.S. 57 (1986).

55. "Sexual harassment which creates a hostile or offensive environment for members of one sex is every bit the arbitrary barrier to sexual equality at the workplace that racial harassment is to racial equality." *Id.* at 67 (quoting Henson v. City of Dundee, 682 F.2d 897, 902-04 (11th Cir. 1982).

economic detriment, forms the basis for such a claim.[56] To maintain an action for sexual harassment under Title VII, a plaintiff must demonstrate that the harassment "alter[s] the conditions of [the victim's] employment and create[s] an abusive working environment."[57] No proof of tangible psychological injury is required, only conduct that creates an "objectively hostile or abusive environment."[58] Hostile environments are created by harassment that is "sufficiently severe or pervasive to alter terms, conditions, or privileges of employment."[59] This requires an objective evaluation to be determined from "looking at all the circumstances."[60] Hostile environment sexual harassment claims require that (1) the employee belongs to a protected class or group; (2) the employee was subject to unwelcome sexual harassment; (3) the harassment complained of was based on sex; (4) the harassment complained of affected a "term, condition or privilege" of employment; and (5) respondeat superior exists.[61]

According to Equal Employment Opportunity Commission (EEOC) guidelines,[62] sexual harassment is conduct which has "the purpose or effect of unreasonably interfering with an individual's work performance or creating an intimidating, hostile or offensive working environment" in the form of "[u]nwelcome sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature."[63] While the level of pervasiveness and abusiveness necessary to constitute such unreasonable interference has been measured from a variety of perspectives, including that of the individual plaintiff,[64] through the eyes of a reasonable person,[65] and in combination.[66]

---

56. *Id.*

57. *Id. See also* Scott v. Sears, Roebuck & Co. 798 F.2d 210, 213 (7th Cir. 1986).

58. Harris v. Forklift Systems, Inc., 114 S. Ct. 367 (1993). In *Harris*, where a manager had been subjected to abusive remarks and sexual innuendo by the company president, the Supreme Court ruled on sexual harassment for the first time since 1986 and confirmed the *Meritor* standard for actionability of a hostile environment claim (including the requirements of an objectively hostile environment *and* the victim's subjective perception of abuse). The *Harris* court also clarified that conduct need not seriously or tangibly effect an employees psychological well-being or lead the employee to suffer injury in order to be actionable as harassment. *Id.* at 370.

59. These circumstances include frequency, severity, level of physical threat or humiliation, and unreasonableness, of interference with work performance. *Harris*, 114 S. Ct. 367, 371 (1993).

60. *Id.*

61. *See* Hall v. Gus Constr. Co., 842 F.2d 1010, 1014-15 (8th Cir. 1988).

62. 29 C.F.R § 1604.11(a)(3)(1987) (EEOC Guidelines).

63. *Id.* While the EEOC Guidelines specifically identify sexual conduct, they do not exclude other types of behavior. Alleged offensive conduct does not have to be purely sexual; if the conduct would not have occurred *but for* the sex of the victim, it can constitute prohibited sexual harassment regardless of whether it was taken with sexual overtones. *See* Hicks v. Gates Rubber Co., 928 F.2d 966 (10th Cir. 1991); Andrews v. City of Philadelphia, 895 F.2d 1469 (3rd Cir. 1990); Lipsett v. University of Puerto Rico, 864 F.2d 881 (1st Cir. 1988); Hall v. Gus Construction Co., 842 F.2d 1010 (8th Cir. 1988).

64. Scott v. Sears, Roebuck & Co., 798 F.2d 210, 214 (that plaintiff considered defendant

In applying the objective component, recent appellate court decisions have suggested that it is appropriate for courts to apply the standard of a "reasonable woman."[67]

For the purposes of class action certification, however, any of these disputes about the proper standards to apply, about the differences in reaction of the class members, or about presenting the prima facie case for hostile environment harassment are, albeit academically interesting, only marginally relevant. Importantly, the propriety of class action treatment is determined without inquiry into the merits of the individual or class claims—the only

---

to be a friend relevant to finding no hostile environment).

65. EEOC Compliance Manual (CCH) § 3113, 3274 (March 19, 1990) (suggests evaluating harassing conduct from objective standpoint of a reasonable person).

66. A number of courts including *Harris* have suggested that both an objective and subjective test should be used. The standard requires an objectively hostile environment—one that a reasonable person would find hostile—as well as the victim's subjective perception that the environment is abusive. Harris v. Forklift Systems, Inc., 114 S. Ct. 367, 370-71 (1993). *See also* Daniels v. Essex Group, Inc., 937 F.2d 1264 (7th Cir. 1991); White v. Federal Express Corp., 939 F.2d 157 (4th Cir. 1991); Ellison v. Brady, 724 F.2d 872 (9th Cir. 1991); Andrews v. City of Philadelphia, 895 F.2d 1469 (3d Cir. 1990); Brooms v. Regal Tube Co., 881 F.2d 412 (7th Cir. 1989); Rabidue v. Osceola Refining Co., 805 F.2d 611 (6th Cir. 1986), *cert. denied*, 481 U.S. 1041 (1987).

67. The Ninth Circuit declared that a court should focus on "the perspective of the victim" in evaluating the severity of sexual harassment. Ellison v. Brady, 924 F.2d 872 (9th Cir. 1991). Thus, *Ellison* offered a new interpretation of the law, using the point of view of the reasonable woman to define sexual harassment. Reasoning that "a sex-blind reasonable person standard tends to be male-biased" and systematically ignores the experiences of women, the court concluded that a "gender-conscious examination of sexual harassment enables women to participate in the workplace on an equal footing with men." *Id.* at 878-79. *See also* Harris v. Int'l Paper Co., 765 F. Supp. 1509, 1515 (D. Me. 1991) (applying "reasonable black person standard" in racial harassment case; "standard for assessing the unwelcomeness and pervasiveness of conduct and speech must be founded on a fair concern for the different social experience of men and women in the case of sexual harassment"); Robinson v. Jacksonville Shipyards, Inc., 760 F. Supp. 1486 (M.D. Fla. 1991) (adopting "reasonable woman" standard and holding that unwelcome harassment is established by behavior disproportionately more offensive or demeaning to one sex); Andrews v. City of Philadelphia, 895 F.2d 1469 (3d Cir. 1990); Jenson v. Eveleth Taconite Co., 824 F. Supp. 847 (D. Minn. 1993).

Although *Harris* presented the Supreme Court with an opportunity to clarify the legal standard for hostile environment sexual harassment claims, the court's opinion did not specifically address whether the objective standard should be the reasonable person or the reasonable victim/woman. Harris v. Forklift Systems, Inc., 114 S. Ct. 367 (1993). However, the district court had found that the conduct would affect "the reasonable woman" or that "[a] reasonable woman would have been offended" by the conduct. App. to Pet. for Cert. (A-33). In the first federal harassment case to be decided *after* Harris, the 7th Circuit court found that the plaintiff's claim failed not because the fondling and forced kissing had not occurred, but because the objective test of whether a reasonable person would have found the environment hostile or abusive had not been satisfied. Saxton v. American Tel. & Tel. Co., 1993 U.S. App. LEXIS 31599 (7th Cir. Dec. 3, 1993). However, the Saxton court declined to decide the appropriateness of using a reasonable woman standard, finding instead that the results of its analysis would be the same whether or not a gendered standard was used. *Id.*

thing required is adherence to Federal Rules of Civil Procedure Rules 23(a) and 23(b).[68] At the certification stage, it is premature to consider or judge whether sexual harassment did in fact occur. All the named plaintiff must do is make an affirmative showing of discrimination.[69] At the class certification stage, if the defendant argues that this showing is without merit, the court can postpone resolution to the time when the case's merits are considered.[70] "In determining the propriety of a class action, the question is not whether the . . . plaintiffs have stated a cause of action or will prevail on the merits, but rather whether the requirements of Rule 23 are met."[71] The *Jenson* court appropriately refused to address the merits of the evidence since such an analysis was unnecessary for questions of class certification.[72]

B. The Use of Class Actions in Title VII Actions

Given this raised consciousness, these expanded remedies, the possible application of a reasonable woman standard and the federal district court certification ruling in *Jenson*, will hostile environment class actions proliferate? The idea of using class actions in Title VII cases is hardly an innovative strategy. Such procedure has always been allowed, even encouraged, in Title VII actions,[73] and class certification has been sought and granted for a variety of sex and race discrimination suits,[74] guided by the reasoned premise that discrimination is by definition class discrimination.[75] Although class actions were an early mainstay of civil rights litigation, the number of class actions has dipped significantly since 1977, due in some part to the Supreme Court's

---

68. Eisen v. Carlisle & Jacquelin, Inc., 417 U.S. 156 (1974).

69. Jenson v. Eveleth Taconite Co., 139 F.R.D. 657, 660 (D. Minn. 1991). Plaintiffs must only allege "an atmosphere of sexual hostility that evidences discrimination." *Id.* (citing Meiresonne v. Marriott Corp., 124 F.R.D. 619, 625 (N.D. Ill. 1989).

70. *Id.* at 661.

71. Miller v. Mackey Int'l, Inc., 452 F.2d 424, 427 (5th Cir. 1971).

72. *Jenson*, 139 F.R.D. at 661.

73. Congress confirmed this approach to Title VII by indicating an intent *not* to affect class action practice under the Act when amended in 1972. LEGAL SERVICES MANUAL FOR TITLE VII LITIGATION National Employment Law Project at 31 (Rev. Oct. 1975). "Title VII actions are by their very nature class complaints, and any restrictions on such actions would greatly undermine the effectiveness of Title VII." Conference Committee of Congress, S. REP. NO. 415, 92nd Cong., 1st Sess. 27 (1971). By so stating, Congress endorsed the use of class actions to eliminate discrimination. No contrary or changed intent was indicated in the 1991 Amendment.

74. Although it has been legally recognized that sexual harassment *is* sex discrimination, the former appears to still be approached as a somewhat more trivial subclass due to the absence of tangible, easily quantifiable harms. Still, for the purposes of this Note and consistent with the finding in *Meritor*, the definition of harassment as discrimination is adhered to, allowing analogy to other kinds of race and sex discrimination cases.

75. *See* Bowe v. Colgate-Palmolive, Co., 416 F.2d 711, 719 (7th Cir. 1969). Oatis v. Crown Zellerbach Corp., 398 F.2d 496, 499 (5th Cir. 1968).

"tightening up" of the requirements for such certification,[76] which dismantled the long held presumption that all such civil rights cases are suitable for class relief.[77] Although only fifty-one employment discrimination class actions were filed in FY 1989,[78] that decrease has leveled off in the past few years.[79] With the advent of sexual harassment certifications, there may well be a rousing revival.

Class actions have long been a popular and effective way of battling employment discrimination. Individuals may bring suit under Title VII of the Civil Rights Act either for themselves or on behalf of a class of persons similarly situated.[80] Given the nature of Title VII violations, where the prohibited discrimination is based on class characteristics, sexual discrimination is at its core a class violation.[81] Prior to 1977, the courts construed the Rule 23 requirements liberally, aware and acknowledging that "suits alleging racial or ethnic discrimination are often by their very nature class suits, involving classwide wrongs [and that] common questions of law or fact are typically present."[82] More recently, the court has required that only after a "rigorous analysis" that the prerequisites of Rule 23(a) have been satisfied can a Title VII class be certified.[83] This shift began in *East Texas Motor Freight v. Rodriguez*,[84] where the Supreme Court reversed appellate court certification of a class of all Blacks and Mexican Americans who had been denied equal employment opportunities and held that careful attention must be made to Rule 23 requirements and that a complaint alleging discrimination would no longer ensure class action certification.[85] That finding required courts to pay close attention to all Rule 23 prerequisites in discrimination actions and suggested that an allegation of discrimination alone would not support an action which challenged a broad range of employer practices. In *General Telephone Company v. Falcon*, the court stressed the need to "evaluate carefully the legitimacy of the named plaintiff's plea that he is a proper class representa-

---

76. *See infra* notes 83-91 and accompanying text.

77. *See, e.g.*, Bowe v. Colgate-Palmolive, Co., 416 F.2d 711; Oatis v. Crown Zellerbach Corp., 398 F.2d 496.

78. John J. Donohue III and Peter Siegelman, *The Changing Nature of Employment Discrimination Litigation*, 43 STAN. L. REV. 983 (1991). Even a smaller portion of those will be certified. This is down 96% from a peak of 1106 in FY 1975. *Id.* at 21.

79. 13 CLASS ACTION REP. 171 (1990).

80. Ronald M. Green, *Class Actions*, 325 P.L.I. LIT. 227 (1987).

81. "A suit for violation of Title VII is necessarily a class action as the evil sought to be ended is discrimination on the basis of a class characteristic, i.e., race, sex, religion or national origin." Bowe v. Colgate-Palmolive Co., 416 F.2d 711, 719 (7th Cir. 1969) (employee sued under Title VII charging intentional discrimination by system of job classification).

82. East Texas Motor Freight Sys. Inc. v. Rodriguez, 431 U.S. 395, 405 (1977).

83. General Telephone Co. v. Falcon, 457 U.S. 147, 161 (1982).

84. *East Texas Motor Freight*, 431 U.S. 395 (1977).

85. *Id.*

tive."[86] To prevail, a plaintiff must bridge a "wide gap between [his] claim" and "the existence of a class of persons who have suffered the same injury . . . such that the . . . [individual] and the [class] will share common questions of law or fact and that the individual's claim will be typical of the class claims."[87] By requiring that a representative meet the Rule 23 requirements for each type of discrimination claim, the *Falcon* court slammed shut the door previously presumed wide open to broad-based class actions.

However, these rulings did not *preclude* the bringing of class actions in discrimination cases, but merely eliminated the presumption that the Rule 23 prerequisites are satisfied for "across-the-board" class actions.[88] Urging that only those cases which clearly exhibited the Rule 23 commonality and typicality be certified, the *Falcon* court required a greater nexus between an individual claim and the allegation that the company had a policy of discrimination. However, many of the cases denying class certification on the grounds of insufficient nexus between the individual and class claims included instances of specific hiring, or promotion discrimination, where the individual circumstances were unique.[89] These should be distinguished from discrimination that effects a term or condition of employment in the form of a hostile environment which would less likely be worker-specific. Given the scrutiny urged by the Supreme Court and the burden on the class plaintiff to provide facts that support her assertion that Rule 23 criteria are fulfilled,[90] there is little chance that baseless class actions will succeed. The question of whether the moving party has met this burden is, however, left "to the sound discretion of the district court."[91]

Allegations of harassment have generally been brought as part of broad based class actions[92] and have not asserted only sexual harassment claims.[93] Nevertheless, harassment-only cases would not be procedurally impossible where there was a continuing, severely hostile workplace environment as long as the class action prerequisites are met.

---

86. *Falcon*, 457 U.S. at 160.

87. *Id.* at 157.

88. *Id.* at 153-54.

89. The facts in *Falcon* can be distinguished from most hostile environment cases, since the plaintiff wished to represent persons injured by employment practices different than those that injured him. A hostile environment is a sole employment practice with a single discriminatory affect on those who must accept it as a condition of their jobs.

90. *See, e.g.*, Roby v. St. Louis S.W. Ry., 775 F.2d 959 (8th Cir. 1985).

91. Rossini v. Ogilvy & Mather, Inc., 798 F.2d 590, 594 (2d Cir. 1986).

92. *See generally* ALBA CONTE, SEXUAL HARASSMENT IN THE WORKPLACE: LAW AND PRACTICE 162 (1990). But, harassment allegations have been included in sex discrimination suits. *See, e.g.*, Jenson v. Eveleth Taconite Co., 824 F. Supp. 847 (D. Minn. 1993). *See also* Meiresonne v. Marriott Corp., 124 F.R.D. 619 (N.D. Ill. 1989); Frazier v. Southeastern Penn. Transp. Auth., Inc., 123 F.R.D. 195 (E.D. Pa. 1988).

93. Sheehan v. Purolator, Inc., 839 F.2d 99 (2d Cir. 1988); Holden v. Burlington N., Inc., 665 F. Supp. 1398 (D. Minn. 1987).

Even though sexual harassment class actions are clearly procedurally appropriate, one could posit three reasons that the first class certified for a claim of hostile environment harassment as sex discrimination did not appear until as late as 1991.[94] First, the liberal approach to prerequisites and presumptive propriety of class action for civil rights suits was chilled by *Falcon* and *Rodriguez*, long before the current wave of sexual harassment awareness and litigation. Second, and perhaps more importantly, the incentive for bringing any kind of discrimination suit has historically been weak, given the paucity of adequate remedies and the acknowledged, deterring hurdle of the significant investment of time, money, and self required to bring such a suit. The dearth of sexual harassment class suits has not been because class actions are in some way legally inappropriate or outmoded.[95] Rather, the failure to use class actions is because there has been little incentive[96]—in fact there are huge *disincentives*—to bringing *any* sex discrimination suits, class or individual, due to the prior lack of available remedies and the fear of retaliation.[97] Finally, only recently has the reasonable woman standard been considered or used to evaluate the hostility of the workplace.[98] This appropriate[99] standard

---

94. Joyce Jenson's case was first filed in 1988. Jenson v. Eveleth Taconite Co., 139 F.R.D. 657 (D. Minn. 1991).

95. Some have opined that "class actions had their day in the sun and kind of petered out." Paul Carrington, official reporter of the Federal Rules of Civil Procedure, in Douglas Martin, *The Rise and Fall of the Class-Action Lawsuit*, N.Y. TIMES, Jan. 8, 1988, at B7, col. 3.

96. "There is little incentive for a plaintiff to bring a Title VII suit when the best that she can hope for is an order . . . to her employer to treat her with the dignity she deserves. One can expect that a potential claimant will pause long before enduring the humiliation of making public the indignities which she has suffered in private. . . ." Mitchell v. OsAir, Inc. 629 F. Supp. 636, 643 (N.D. Ohio 1986) (holding employer strictly liable for sexual harassment in a hostile environment case).

97. New York City's first female firefighter, who had sued the city to force it to hire women, was not only harassed for bringing suit but also received numerous death threats. *See Sex, Power and the Workplace*, *supra* note 3.

98. *See generally* Toni Lester, *The Reasonable Woman Test in Sexual Harassment Law—Will It Really Make a Difference?*, 26 IND. L. REV. 227 (1993) (suggesting women would win harassment suits more often if federal courts were required to apply the reasonable woman test). Significantly, the Jenson court employed the "reasonable woman" standard in finding liability, concluding that the reasonable woman would find that the working conditions at Eveleth's mines affected the terms and conditions of her employment. Jenson v. Eveleth Taconite Co., 824 F. Supp. 847, 885 (1993). *See supra* note 67 and accompanying text.

99. Differences in perception are attributable to the fact of gender. Jenson v. Eveleth Taconite Co., 824 F. Supp. 847, 885 (1993). "As with many gender-related issues however, men, when they are in the majority and when they control the avenues of power, and thus are generally immune to unwelcome conduct, may fail to observe what a reasonable woman perceives on a continual basis." *Id. See infra* note 138. Because men are rarely victims of sexual assault, they tend to view sexual conduct in a vacuum "without full appreciation of the social setting or the underlying threat of violence that a woman may perceive." Ellison v. Brady, 924 F.2d 872 (9th Cir. 1991).

is consistent with finding commonality and typicality[100] in these claims, and continued and expanded judicial application of this standard will support greater numbers of class action certifications.

III. Rule 23 Requirements Can be Met in Hostile Environment Sexual Harassment Cases

While some were surprised at the *Jenson* certification, believing it ran counter to the prevailing wisdom that sexual harassment is too discrete and too individualized a violation to be afforded class action treatment,[101] an analysis of the Rule 23 requirements[102] actually shows hostile environment claims to be well suited to such treatment. This is especially true given the recent decisions of a number of circuits suggesting the use of a reasonable woman standard to evaluate sexual harassment claims.[103] The Rule 23 requirements for maintaining a class action are broadly viewed in race and sex discrimination cases[104] and ask only that the plaintiff satisfy numerosity,[105] commonality,[106] typicality[107] and adequacy of representation.[108] Hostile environment cases could withstand such rigorous analysis. By examining each of these requirements[109] in light of the facts and the law of sexual harassment

---

100. *See supra* notes 135-84 and accompanying text.

101. *See* Charles Mishkind, *Sexual Harassment Hostile Work Environment Class Actions: Is There Cause for Concern?* 18 Empl. Rel. L.J. 141 (1992).

102. Rule 23 states, in pertinent part:

> (a) One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, 3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

Fed. R. Civ. P. 23(a)

> An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition: (1) the prosecution of separate actions by or against individual members of the class would create a risk of [inconsistent or varying adjudications or which would be, as a practical matter, dispositive of other members' interests]; or (2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or (3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy.

Fed. R. Civ. P. 23(b).

103. *See supra* notes 67, 98 and accompanying text.

104. *See, e.g.*, Green v. USX Corp., 843 F.2d 1511, 1534 (3d Cir. 1988).

105. Fed. R. Civ. P. 23(a)(1).

106. Fed. R. Civ. P. 23(a)(2).

107. Fed. R. Civ. P. 23(a)(3).

108. Fed. R. Civ. P. 23(a)(4).

109. For a class to be certified, the named plaintiff must prove the requirements of

cases, most hostile environment claims can be shown to meet these requirements and therefore are appropriate for class action certification.

A. Numerosity

The first prerequisite of Rule 23 is that the class upon whose behalf the representative is suing is "so numerous that joinder of all members is impracticable."[110] While the term "numerous" would seem to demand great numbers of potential class members to show extreme difficulty or inconvenience of joinder, the quantity of members is not in itself the benchmark for measurement. "No magic number exists in order [to] satisfy the numerosity requirement."[111] While the numerosity requirement can be met on sheer magnitude, it also takes into account all other factors affecting the impracticability of joinder. Courts have suggested a flexible standard for numerosity in employment discrimination suits which are "particularity fit for class action treatment."[112] Other factors affecting practicability of joinder include the location of class members, the type of action, the injunctive nature of the claim, the size of the claims involved, the person bringing the action, the convenience of conducting individual lawsuits, and other factors pertinent to propriety of joinder such as the potential of retaliation by employers which would prevent employees from joining the class without such a class procedure.[113] While class actions are most often associated with mass tort actions that involve and affect hundreds or thousands of class members, Rule 23 requires only that joinder be impracticable, not impossible.[114] Class actions have been brought with less than thirty class members.[115]

All of the aforementioned factors are relevant to discourage joinder in sexual harassment suits. Despite current higher levels of awareness, the unwillingness of women to bring individual suits, or to join in a claim, for fear

---

numerosity, commonality, typicality and adequacy of representation have been met. Wetzel v. Liberty Mut. Ins., Co., 508 F.2d 239, 246 (3d Cir. 1975).

110. FED. R. CIV. P. 23(a)(1).

111. Frazier v. Southeastern Penn. Trans. Auth., Inc., 123 F.R.D. 195, 196 (E.D. Pa. 1988) (court granted certification to three classes of plaintiffs suing the transportation authority claiming racial and sex discrimination) (citing Snider v. Upjohn Co., 115 F.R.D. 536, 539 (E.D. Pa. 1987)).

112. Slanina v. William Penn Parking Corp., 106 F.R.D. 419, 423 (W.D. Pa. 1984).

113. R. Green, *supra* note 80, at 230. *See also* Alba Conte, *Class Action: Remedy for the Hostile Environment*, TRIAL, July 1992, at 19.

114. Practicality is the key in evaluating the number of prospective class members: "practicability" is not equivalent to "impossibility." Samuels v. University of Pittsburgh, 56 F.R.D. 435, 439 (W.D. Pa. 1972).

115. *See, e.g.*, Cypress v. Newport News Gen. & Nonsectarian Hosp. Ass'n., 375 F.2d 648 (4th Cir. 1967) (18 identifiable members); Sabala v. Western Gillette, Inc., 362 F. Supp. 1142 (S.D. Texas 1973) (26 class members enough); Slanina v. William Penn Parking Corp., 106 F.R.D. 419 (25 members); Hoston v. United States Gypsum, Co., 67 F.R.D. (E.D. La. 1975) (23-33 members).

of humiliation, interrogation, retaliation or termination remains an obstacle in these cases.[116] Current employees may be hesitant to join a suit, because employees have a strong interest in maintaining good relationships at work.[117] The courts often consider fear of retaliation against individual plaintiffs when considering numerosity in a race or sex discrimination suit.[118] In some cases, plaintiffs may not even argue the impracticability, inconvenience, dispersion, or size of the class but may rely on claimed fear of retaliation toward current employees as a factor that renders joinder impracticable if not impossible.[119]

By including future "reasonable people" whom the hostile environment would similarly affect, the class can be made more numerous.[120] An injunction against future discrimination could be considered "prospective relief," and the size of the prospective class could be extrapolated outwards to include these currently unidentifiable class members.[121] These "unnamed, unknown" future employees[122] are appropriate class members[123] in that they would benefit from the injunctive relief that the named plaintiff seeks: the removal of open hostility or veiled misogyny from the environment. Joinder of these unknown individuals would certainly be impractical.[124]

In any case, one of the purposes of class actions is efficiency, and courts may find that the economies of class litigation outweigh any concerns about the number of plaintiffs.[125] Especially in cases where injunctive or declara-

---

116. Freda Klein, sexual harassment training consultant, suggested that even today those who have nothing but private conversations to report still are reluctant to come forward, learning from the Thomas hearings that "when it's her word against his, he wins." *Morning Edition* (National Public Radio broadcast, May 7, 1992) (available in LEXIS, NEXIS library, NPR file). A majority of women lawyers who had experienced harassment on the job did not report such incidents, despite the existence of formal, written harassment policies. Thom Weidlich & Charlise K. Lawrence, *Sex and the Firms: A Progress Report*, THE NATIONAL LAW JOURNAL, Dec. 20, 1993 at 1.

117. One court even took judicial notice "that employees are apprehensive concerning loss of jobs and the welfare of their families. They are frequently unwilling to pioneer an undertaking of this kind. . . ." Horn v. Associated Wholesale Grocers, 555 F.2d 270, 275 (10th Cir. 1977).

118. *See* Frazier v. Southeastern Penn. Trans. Auth., Inc., 123 F.R.D. 195, 197 (E.D. Pa. 1988); Slanina v. William Penn Parking Corp., 106 F.R.D. at 423 (W. D. Pa. 1984).

119. Even when the number of class members is small, courts realize that "[c]omplicating an employee's ability to pursue his own claim is the fear that his job will be jeopardized by bringing his employer to court." Allen v. Isaac, 99 F.R.D. 45, 53 (N.D. Ill. 1983).

120. CHARLES R. RICHEY, MANUAL ON EMPLOYMENT DISCRIMINATION AND CIVIL RIGHTS ACTIONS IN THE FEDERAL COURTS A-57 (1988).

121. Conte, *supra* note 113, at 19.

122. *See, e.g.*, Jack v. American Linen Supply Co., 498 F.2d 122, 124 (5th Cir. 1974).

123. The assumption is that as a result of the current practice, if not enjoined, those future employees would be discriminated against with regard to the terms and conditions of their employment because of their sex. Jenson v. Eveleth Taconite Co., 139 F.R.D. 657, 659 (D. Minn. 1991) (Plaintiff's motion to certify the class, at 2).

124. *Jack*, 498 F.2d at 124.

125. *Jenson*, 139 F.R.D. at 664 (quoting American Pipe and Constr. v. Utah, 414 U.S. 538,

tory relief is sought, individual disinterest or less than unanimous support[126] is not enough to defeat the numerosity requirement where all members would benefit from the relief.

The courts have been careful to distinguish questions on the merits of the case from those impacting fulfillment of the prerequisite numerosity.[127] In a case where the defendant contended that the description of the class was incorrect and thus not numerous, the courts warned that such a defense was merit-oriented and not a proper inquiry for determination of class certification.[128] If the plaintiff's allegations are correct, numerosity is met; if proven wrong on the merits, then the class can be decertified.[129]

In determining whether joinder of individual suits is practicable, courts also consider the potential size of recovery and the chance that individual cases would be brought. In the past, the relatively scant recovery afforded to individual plaintiffs discouraged them from bringing such suits. Also, individual sexual harassment cases are difficult to prove, making it harder to obtain counsel, because there is greater chance of loss and slimmer opportunity for settlement.[130]

Given the new remedies available, the argument could be made that the incentive of individual, monetary damages might renew a woman's interest in bringing and controlling her own suit in order to take maximum advantage of the monetary relief available. However, when *net* recovery is calculated, not only in terms of damages received, but taking into consideration the financial, emotional and physical[131] costs incurred, the desire to bring individual suits appears less enticing.[132] Furthermore, the damages cap[133] in the Civil Rights Act of 1991 offers a reality check to any imagined visions of punitive windfalls. And, if a woman chooses to opt out of the class, it is unlikely that significantly different damages would be awarded her in a later individual suit if she was in fact very similarly situated in the environment.

---

553 (1974)).

126. *Id.*

127. Not all commentators agree with this approach. *See generally* Rutherglen, *Title VII Class Actions*, 47 U. CHI. L. REV. 688 (1980).

128. Meiresonne v. Marriott Corp., 124 F.R.D. 619 (N.D.Ill. 1989).

129. *Id.*

130. Johnson, *supra* note 13, at 59.

131. Research shows that harassment is linked to self-blame, depression and anxiety. JANA HOWARD CAREY, SEXUAL HARASSMENT IN THE WORKPLACE, 426 PLI Lit. 49 (1992). Also, harassment can cause physical symptoms such as nausea, cramps, headaches, and loss of sleep. *Id.*

132. As seen in the *Meritor* case, a plaintiff who alleges harassment in effect makes her personal life fair game, getting little protection from the court, and opening herself up to inspection of medical records, sexual history, etc. *Thomas Hearings, supra* note 8, at 1464.

133. To protect employers, damage caps are set based on size of the company, from a limit of $50,000 for employers with fewer that 100 employees to $300,000 for large firms with more than 500 employees. Civil Rights Act of 1991, Pub. L. No. 102-166 (105 Stat. 1071) § 102.

In the cases where numerosity is a close call, courts can and should err on the side of finding numerosity fulfilled, and then decertify the class if information presented later defeats the proposition.[134]

B. Commonality

The second requirement, that "there [be] questions of law or fact common to the class,"[135] is especially appropriate to hostile environment claims, evinced in a "common thread of discrimination" in the form of hostility woven throughout the workplace.[136] At its core, harassment is a group-based, community experience.[137] Usually what one woman finds unwelcome will be what most women find unwelcome.[138] Since individual experiences derive from a social context, the same thing does not happen or feel the same to every woman, yet the factors that explain and comprise sexual harassment characterize all women's situations.[139]

The key to decisions about whether the prerequisite of commonality in sex discrimination cases has been met is how the common questions are defined. In evaluating commonality the court looks at relevant criteria such as whether the unlawful practice charged affected only a few employees or had a genuine classwide impact; how uniform or diverse are the relevant employment practices of the employer; how uniform or diverse is the membership of the class in terms of the likelihood that the members' treatment will involve common questions; the degree of the employer's centralization and uniformity

---

134. FED. R. CIV. P. 23(c)(2).

135. FED. R. CIV. P. 23(a)(2) (commonality required).

136. Jordan v. County of L.A., 669 F.2d. 1311, 1322 (9th Cir. 1982), *vacated*, 459 U.S. 810 (1982). *See also* Avagliano v. Sumitomo Shoji American, Inc., 103 F.R.D. 562, 582 (S.D.N.Y. 1984) (quoting Paxton v. Union Nat'l Bank, 688 F.2d 552, 561 (8th Cir. 1982).

137. "One woman can bring a legal complaint but the group-based nature of the claim that one's treatment is based on sex requires that the complaint refer to a group-based experience in one way or another." Thomas I. Emerson, *Foreward* to CATHARINE A. MACKINNON, SEXUAL HARASSMENT OF WORKING WOMEN at xii-xiii (1979). "It is this level of community that makes sexual harassment a woman's experience, not merely an experience of a series of individuals who happen to be of the female sex." *Id.*

138. Note, *Sexual Harassment Claims of Abusive Work Environment Under Title VII*, 97 HARV. L. REV. 1449, 1451 (1984) (many actions women find offensive are perceived as harmless by men). There are often distinct differences in how men and women perceive harassing behavior. For example, seven in ten female lawyers say the problem exists in their firms, while only four in ten male lawyers agree. Thom Weidlich & Charlise K. Lawrence, *Sex and the Firms: A Progress Report*, THE NATIONAL LAW JOURNAL, Dec. 20, 1993 at 1. A study of 20,000 federal employees suggests that men tend to feel the problem of workplace sexual harassment was greatly exagerated, while women did not, and that men were more likely to believe women brought harassment on themselves. Office of Merit Sys. Review and Studies, U.S. Merit Sys. Protection Bd., Sexual Harassment in the Fed. Workplace, Is It A Problem? (1981) (cited in Lester, *supra* note 98).

139. Thomas I. Emerson, *Foreward* to CATHARINE A. MACKINNON, SEXUAL HARASSMENT OF WORKING WOMEN at xii (1979).

of policies and practices; and the length of time covered by allegations and how possible that similar condition prevailed throughout that period.[140] The certification in *Jenson* resulted from a finding that the common question of law was whether Eveleth Mines discriminated against women, not the fact patterns experienced by individual women or the varied and incidental acts.[141]

Those who view sexual harassment as an intensely individual violation where reactions to the harassing behaviors are distinctive and not amenable to classwide adjudication believe class certification should fail in these cases.[142] Some courts have generally concluded that although there is "evidence indicating that incidents of sexual harassment occur" that "this form of discrimination simply is not amenable to class treatment."[143] However, the growing use of a standard to evaluate whether a reasonable woman[144] would have considered the conduct severe or pervasive enough to alter conditions of employment militates against the myth that sexual harassment is a highly individualized offense highly dependent on the subjective reactions and realities of each woman involved.[145]

The commonality in a hostile environment claim is as intrinsic as it is interpretable. The women being represented endure "a workplace pervaded by sexual slur, insult and innuendo,"[146] and even if they are not directly harassed[147] they are affected by the same manipulations.[148] The issues

---

140. *See* Harris v. Pan American World Airways, Inc., 74 F.R.D. 24 (N.D. Cal. 1977).

141. Jenson v. Eveleth Taconite Co., 139 F.R.D. 657, 663 (D. Minn. 1991).

142. *See* Mishkind, *supra* note 101, at 143. How stringently restrictions are applied to class certifications depends in large part on whether discrimination is presumed to be "a discrete and isolated occurrence" or "a discriminatory policy [that] affect[s] different class members" in "varying ways." Jordan v. County of L.A., 669 F.2d. 1311, 1322 (9th Cir. 1982), *vacated*, 459 U.S. 810 (1982).

143. In International Union v. LTV Aerospace and Defense Co., the court, in denying certification of a class composed of female employees who alleged individual acts of hostile environment sexual harassment, reasoned that the complaints were "too individualized." 136 F.R.D. 113, 130 (N.D. Tex. 1991). The court summarily dismissed the claim as "not amenable to class treatment," warning that defenses to these claims would "likely be very fact specific, and including these claims in the larger class action would cause the case to devolve into a series of individual trials." *Id.*

144. *See supra* notes 67, 98 and accompanying text.

145. The presumption that the employer discriminated against *individual* class members does not arise from the determination that a reasonable woman would have been affected. The individual will have to show subjective response to the harassment before she is entitled to damages. Because subjective response is an essential part of proving the claim, she must still prove that she was affected, at least as affected as the reasonable woman. The other elements are established by the court's determination in the liability phase of the proceedings. Jenson v. Eveleth Taconite Co., 824 F. Supp. 847, 876 (1993). This burden has been significantly lightened by the Supreme Court holding in Harris that no psychological harm need be shown. Harris v. Forklift Sys., 114 S. Ct. 367 (1993).

146. Katz v. Dole, 709 F.2d 251, 255 (4th Cir. 1983).

147. Even if harassment is directed at employees other than the individual plaintiff, that evidence might be relevant to show hostile environment. Thus, even "non-victims" can still make

determinative of whether an environment is so hostile as to be discriminatory are likely to be common among a class of co-workers. The effect of the use of the reasonable woman standard on meeting the prerequisite of commonality was shown in the *Jenson* case, where the court disagreed with the contention that reactions to profanity are highly individualized. The fact that individual female plaintiffs may have had different reactions to alleged profanity, pornography or other potentially offensive material in the workplace did not preclude certification of class—the common question was "not how individual class members reacted but whether reasonable women would find the work environment hostile."[149]

While earlier cases have suggested that claims of retaliation and sexual harassment often require highly individualized proof and are thus unsuitable for class action,[150] this view is inconsistent with more recent rulings and application of the reasonable woman standard. Even if individual suits remain the most appropriate strategy for pursuing *quid pro quo* sexual harassment claims,[151] a hostile environment, by definition, suggests that the discriminatory conduct endured by one plaintiff is similar to that affecting the class, and the relief requested must be compatible and appropriate for the class.[152] Even in cases where a "single discriminatory policy may affect different employees differently, whether the policy itself is discriminatory is a question of fact common to all members of the class."[153]

The shift of focus[154]—from the plaintiff's reaction to the defendant's

---

a claim for discrimination based on the harassment that surrounds them. *See, e.g.*, Hall v. Gus Constr. Co., 842 F.2d 1010, 1015 (8th Cir. 1988).

148. An examination of the totality of the circumstances looks at a pattern of conduct that affects a victim directly and "reverberates throughout the work environment." The "subliminal nature of such conduct . . . affects everyone in the workplace." CONTE, *supra* note 92, at 97. The posting of sexually-oriented materials in common areas may serve as evidence or a hostile environment. Bennett v. Corroon & Black Corp., 845 F.2d 104, 106 (5th Cir. 1988). The pervasive use of derogatory and insulting terms to women generally and to women personally may also serve as evidence of hostile environment. Andrews v. City of Philadelphia, 895 F.2d 1469, 1485 (3d Cir. 1990).

149. Jenson v. Eveleth Taconite Co., 139 F.R.D. 657, 665 (D.Minn. 1991). *See also* Ellison v. Brady, 924 F.2d 872 (9th Cir. 1991); Andrews v. City of Philadelphia, 895 F.2d 1469, 1485 (3rd Cir. 1990). The determination of whether the employer exposed women to a sexually hostile environment is the focus of the liability phase of the class claim because "at issue therein is the common question of law which makes a class action an appropriate vehicle for prosecuting claims of sexual harassment." *Jenson*, 824 F. Supp. 847, 875.

150. *See, e.g.*, Sheehan v. Purolator, Inc., 103 F.R.D. 641 (E.D.N.Y. 1984).

151. *See supra* note 15.

152. R. Green, *supra* note 80, at 232.

153. *Id.* at 231.

154. "[T]he focus of the question of sexual harassment should be on the defendant's conduct, not the plaintiff's perception or reaction to the defendant's conduct." Scott v. Sears, Roebuck & Co., 605 F. Supp. 1047, 1056, *aff'd in part and rev'd in part on other grounds*, 581 F.2d 941 (D.C. Cir. 1978) (quoting Jennings v. D.H.L. Airlines, 101 F.R.D. 549, 551 (N.D. Ill.

conduct—in essence makes moot the question of individualized response to harassment. Concern about the "uniqueness" of harassment claims is without much merit given this appropriate new focus on behavior, not reactions. Further, adopting the reasonable woman standard to measure the severity of these claims minimizes the need for individualized analysis of reaction to prove hostility; rather, that standard evaluates the action as to whether a reasonable woman would have been bothered by it, and minimizes the subjective, and admittedly varying, reactions of any individual plaintiff.[155]

Except for class actions maintained where common questions must predominate over individualized ones,[156] "commonality is not a demanding requirement," mandating only "one issue of law or fact common to the claims of the class members."[157] Common questions of fact are likely to predominate where a pattern of discrimination is alleged; if necessary, the class could be subdivided into subclasses later to assure factual commonality within the class.[158]

In an analysis of commonality, the facts do not have to be identical, and disparities can be superseded by operation of pervasive discriminatory employment policy.[159] "Factual differences between individuals are to be expected and will not preclude a class action."[160] Perhaps no policy is more pervasive than a hostile environment which touches and scorns all who dare enter it.

Also worthy of consideration is the fact that courts have found it unnecessary for the intimidation and insult to be sexual in nature.[161] All that is necessary is that if the plaintiff "had been a man she would not have been treated in the same manner."[162] This would further minimize the need to examine the sexual proclivities or sensibilities of any particular woman.

1984); Robinson v. Jacksonville Shipyards, Inc., 760 F. Supp. 1486 (M.D. Fla. 1991) (shifting focus from individual response to harassment itself).

155. If the employer is liable for creating a hostile environment because a reasonable person would have found the conditions abusive, damages are then determined on an individual basis. Although individual class members must prove they were subjectively affected at least as much as a reasonable person would be in order to recover, the greater hurdle (establishment of a hostile environment) is determined in the liability phase. Proof of subjective reaction may have been an obstacle when psychological harm or injury was required. But *Harris* lowered that hurdle by holding that harassment is actionable without economic, tangible, or serious or concrete effect on psychological well being. *Harris*, 114 S. Ct. 367, 371 (1993).

156. FED. R. CIV. P. 23(b)(3).

157. *See, e.g.*, Armstrong v. Chicago Park Dist., 117 F.R.D. 623, 628 (N.D. Ill. 1987).

158. Johnson v. Georgia Highway Exp., Inc., 417 F.2d 1122 (5th Cir. 1969).

159. Oatis v. Crown Zellerbach Corp., 398 F.2d 496 (5th Cir. 1968).

160. Jenson v. Eveleth Taconite Co., 139 F.R.D. 657, 661 (D. Minn. 1991) (quoting Coley v. Clinton, 635 F.2d 1364 (8th Cir. 1980)).

161. Hall v. Gus Const. Co., 842 F.2d 1010 (8th Cir. 1988) (intimidation and hostility can result from other than sexual conduct).

162. Tompkins v. Public Serv. Elec. & Gas Co., 568 F.2d 1044, 1047 n.4 (3d Cir. 1977) (quoting Skelton v. Blazano, 424 F. Supp. 1231, 1235 (D.D.C. 1976)).

The *Ellison* court indicated that it was the harasser's conduct that must be pervasive or severe, not the alteration in the conditions of employment.[163] "[E]mployees need not endure sexual harassment until their psychological well-being is seriously affected to the extent that they suffer anxiety and debilitation."[164] This too would undermine the theory that differences in plaintiff reaction or sensitivity should preclude the propriety of class certification because of lack of commonality. If what matters is that the conduct is pervasive, or that the environment is hostile or abusive, or that the conduct would be offensive to a reasonable woman, then the determination can be made by examining the facts of the environment, and by assuming that the pervasiveness, abusiveness, and hostility would impact all reasonable women exposed to that environment.

Even the EEOC policy statement suggests that an "objective standpoint" of a "reasonable person" should be taken and applied, but suggests that "petty slights" suffered by "hypersensitive" plaintiffs are not actionable.[165] A closely woven net is best used to collect the class members in these cases. To restrictively apply the prerequisites of commonality and typicality in the zealous attempt to screen out the few women who may have not been offended (at least not consciously) is to deny many thousands of woman who have been harmed a practical means of obtaining justice.

C. Typicality

The third requirement, typicality, also is intrinsically linked to the types of claims made. The typicality requirement asks whether "the claims or defenses of the representative parties [are] typical of the claims or defenses of the class"[166] or whether the representative "possess[ed] the same interest and suffer[ed] the same injury"[167] as the class members. Although it is often confused with commonality, this requirement focuses not on the broad picture of whether there is an identifiable class but whether this representative is an appropriate representative for the class because her claim is typical.[168] Commonality concerns whether there is a commonality of relationship among all the class claims, while typicality focuses on the similarity of the representa-

---

163. Meritor Sav. Bank, FSB v. Vinson, 477 U.S. 57 (1986) (quoting Ellison v. Brady, 924 F.2d 872, 878 (9th Cir. 1991)).

164. *Ellison*, 924 F.2d at 878.

165. EEOC: Policy Guidance on Sexual Harassment, 8 Fair Empl. Prac. Man. (BNA) 405:6681 (March 19, 1990) (Guidelines urge consideration of whether conduct was verbal or physical or both; whether conduct was frequently repeated; whether conduct was hostile and patently offensive; whether alleged harasser was co-worker or supervisor; whether others joined in perpetuating the harassment; whether the harassment was directed at more than one individual).

166. FED. R. CIV. P. 23(a)(3).

167. East Texas Motor Freight Sys. v. Rodriguez, 431 U.S. 395, 403 (1977) (quoting Schlesinger v. Reservists Committee, 418 U.S. 208, 216 (1975)).

168. R. Green, *supra* note 80, at 231.

tive's claim to that of the rest of the class.[169] Since, to be typical, a plaintiff's claim must have something in common with other class members' claims, the requirements of typicality and commonality "tend to merge."[170] The typicality requirement is intended to protect plaintiffs and defendants from being represented by a person whose stake in the action is dissimilar to theirs, to insure that they will not be involved in unwarranted or unnecessary adjudication, and to promote the judicial economy that is the central concept of class actions.[171] To the extent that the same evidence used to prove each individual claim would be relevant to prove the class claim, typicality is established.[172]

"Typicality requirements may be satisfied even if there are factual dissimilarities or variation."[173] It fails only in instances with very unique fact patterns, employment circumstance or defenses.[174] This uniqueness is unlikely in a hostile environment case, since such environment by definition surrounds and touches all. Even in cases where the named plaintiff was the only one directly approached, co-workers still may be offended, that is, harassed, by such activities. Indeed, courts have found harassment in claims by persons who were indirect victims of the harassment since even visual or verbal assaults not directed at a particular female employee "sexualizes the work environment to the detriment of all female employees."[175] Like second-hand smoke, such hostility directed toward other women can choke even those who do not participate or who would attempt to ignore or escape it.

Differing experiences of retaliation also do not render a claim atypical for purpose of class certification.[176] Barring certification for that reason would illogically encourage defendants to insulate themselves from class actions by retaliating against anyone who brought a charge.[177]

The other typicality problems that exist in discrimination cases involve multiple facilities or geography, where corporate practices may differ.[178] However, these are less likely in a hostile environment sexual harassment case where the discrimination is usually concentrated in a single environment.

---

169. *Id.*

170. General Telephone Co. v. Falcon, 457 U.S. 147, 157 n.13 (1982); *see* Rossini v. Ogilvy & Mather, Inc., 798 F.2d 590, 597 (2d Cir. 1986).

171. 6 Federal Procedure L.Ed. Class Actions § 12:81.

172. *See* Jenson v. Eveleth Taconite Co, 139 F.R.D. 657, 665 (D. Minn. 1991).

173. 15 CLASS ACTION REPORT 122 (1992).

174. *See, e.g.,* Sheehan v. Purolator, Inc., 103 F.R.D. 641 (S.D. N.Y. 1984), *aff'd*, 839 F.2d 99 (2d Cir. 1988).

175. Robinson v. Jacksonville Shipyards, Inc., 760 F. Supp. 1486, 1504 (M.D. Fla. 1991).

176. *See* Meiresonne v. Marriott Corp., 124 F.R.D. 619, 624 (N.D. Ill. 1989).

177. *Id.*

178. R. Green, *supra* note 80, at 232.

Especially where plaintiffs do not claim damages for all class members based on individual incidents of sexual hostility but allege an atmosphere that evidences discrimination, as was the case in both *Meiresonne* and *Jenson*, there is no need to provide conclusive proof that an identical hostile atmosphere exists for every class member.[179] Where plaintiffs had chronicled a dozen individual incidents of sexual hostility, plus expressions of the general harassing attitudes, the court found typicality.[180] Similarities in employment conditions, discriminatory practices and type of relief sought also show that plaintiffs' claims are aligned with those of the other class members.[181]

Another factor in determining typicality is if the claims would be the same whether brought by an individual or a class, and if evidence used to prove each individual claim would be relevant to prove the class claims.[182] It would certainly be inefficient to go through a series of trials where woman after woman provided evidence to show that the environment was characterized by offensive words, pictures and actions. All those in the environment subjected to it and affected by it would proffer similar proof.

Typicality only requires an employee who can "press with substantially equal vigor or ability."[183] Just as commonality does not require named plaintiffs to clone all other class members in terms of sensitivity or reaction, typicality does not require the class representative be identical to those she represents, in terms of rank, job description, or other employment characteristic.[184]

D. Adequacy of Representation

The final prerequisite to class action is the adequacy of representation, that the named plaintiff(s) "will fairly and adequately protect the interests of the class."[185] Considered here are whether the counsel is competent,[186] whether

---

179. *Meiresonne*, 124 F.R.D. at 625.

180. *Id.* (Memorandum in support of Plaintiff's Motion to Certify the Class and to Consolidate Consideration of Class Issues with Trial, at 15).

181. Conte, *supra* note 113, at 20.

182. *See* Jenson v. Eveleth Taconite Co., 139 F.R.D. 657, 665 n.19 (D. Minn. 1991).

183. Johnson, *supra* note 13, at 61.

184. If such identity of function were required, all classes of professional employees would likely be precluded from class certification. *See* Meyer v. MacMillan Pub. Co., 95 F.R.D. 411 (S.D.N.Y. 1982). In *Jenson*, named plaintiffs were allowed only to represent hourly and not salaried workers, because there were different hiring and promotion schemes. "In traditional employment discrimination cases, variations based on salary and seniority do not render claims atypical for class certification purposes." Conte, *supra* note 113, at 20.

185. FED. R. CIV. P. 23(a)(4).

186. Unless there is evidence to the contrary, this is usually assumed. Defendants have unsuccessfully attempted to suggest that the stress caused by the harassment rendered the plaintiff an inadequate representative for the class. Conte, *supra* note 113, at 20 n.22.

any collusion is possible and whether named plaintiff's interest are antagonistic to the class she represents.[187]

This requirement should be easily met, absent any interest truly antagonistic to the class. Even disagreements regarding the preferred remedy do not provide sufficient antagonism to defeat a claim of adequate representation. Differing levels of interest among prospective class members alone will not defeat the adequacy requirement.[188] Adequacy of representation has not proven to be a difficult requirement to meet. Claims of antagonistic interest between the named plaintiff and other female co-workers she seeks to represent because they were, in effect, competing for the same jobs and promotions have been deemed "absurd" by the courts, reasoning that to discredit adequacy by such a logic would doom almost every workplace action.[189] Moreover, any intraclass conflict alleged to defeat the adequacy of representation could be remedied easily by the provisions for notice and opting out; any class member could choose not to participate in the class action.[190]

A showing of adequacy may require at least an active interest and familiarity with the case, someone willing to act for the class and not just to promote or preserve self-interest.[191] Since a named plaintiff in a sexual harassment case must first have expended the effort to exhaust administrative remedies,[192] at least some level of interest and familiarity can be assumed. Given the intensely personal nature of the claim, finding a plaintiff with an active interest would likely not be difficult. Familiarity with the facts of a hostile environment claim could be imputed to a woman who had worked in that environment for a period of time. While finances may be a concern, attorney's fees are usually available in Title VII,[193] and attorneys could

---

187. JACK H. FRIEDENTHAL, MARY KAY KANE AND ARTHUR R. MILLER, CIVIL PROCEDURE § 16.2 (1985).

188. Hedge v. Lyng, 689 F. Supp. 884 (D. Minn. 1987) (plaintiff seeking to represent class does not have to show all members would agree with her in order to qualify as adequate representative).

189. Meiresonne v. Marriott Corp., 124 F.R.D. 619, 625 (N.D. Ill. 1989).

190. *See, e.g.*, U.A.W. v. LTV Aerospace and Defense Co., 136 F.R.D. 113, 125 (N.D. Tex. 1991).

191. *See, e.g.*, Kuenz v. Goodyear Tire & Rubber Co., 104 F.R.D. 474 (E.D. Mo. 1985); Wofford v. Safeway Stores, 78 F.R.D. 460, 487 (N.D. Cal. 1978).

192. An individual satisfied the requirements by filing a timely charge with EEOC and acting pursuant to an EEOC right-to-sue letter. McDonnell Douglas Corp. v. Green, 411 U.S. 792 (1973).

193. Title VII authorizes an award of attorney's fees to the "prevailing party." 42 U.S.C. § 2000e-5(k). This has been interpreted to mean such fees are required "unless special circumstances would render an award unjust." Christianburg Garmant Co. v. EEOC, 434 U.S. 412 (1978). Because the plaintiffs in Jenson prevailed on their claims of sexual harassment, they were awarded reasonable attorney's fees. *Jenson*, 824 F. Supp. 847, 889.

advance those to the plaintiff.[194] Generally this aspect of adequacy is not scrutinized. Given the depth and energy of feeling that have surfaced, finding committed plaintiffs[195] and attorneys willing to finance the suits should not be difficult.

E. Maintainability of the Suit: Fulfillment of 23(b)(2) and 23(b)(3)

In addition to meeting the four prerequisites, the claimant seeking class certification must overcome an additional hurdle by positioning itself under one of the three subsections of Rule 23(b): (1) either the prosecution of separate actions risks inconsistent adjudications or would, as a practical matter, be dispositive of the interests of non-participants;[196] (2) where the opposing party has acted or refused to act on grounds generally applicable to the class, and where injunctive or declaratory relief is appropriate;[197] and (3) common questions of law or fact predominate over individual questions.[198] While most discrimination cases have been certified as 23(b)(2) cases which contemplated declaratory and injunctive relief, this may be because that was the sole relief available. The fact that the Civil Rights Act of 1991 now offers compensatory and punitive damages should invite class actions certified under 23(b)(3), which usually applies to actions where damages are sought. While this section requires an additional finding that "questions of law or fact common to the members of a class predominate over any questions affecting only individual members" and that the procedure is "superior to other available methods for the fair and efficient adjudication of the controversy,"[199] such a situation could be found in hostile environment sexual harassment cases if matters similar to those used to assess joinder impracticability are considered. For example, the interest an individual class member might have in controlling his or her separate action,[200] the extent and nature of litigation already commenced, the desirability of concentrating the litigation in a particular forum, and the difficulties likely to be encountered in managing the action. The additional burden of notice required by a 23(b)(3) action would be minimal,

---

194. MODEL RULES OF PROFESSIONAL CONDUCT 1.8(e)(1)-(2) (Aug. 1983).

195. Class representatives need to have "a sense of identity with and an emotional tie to the class . . . [or] be motivated by a personal drive to eradicate general injustice against his class." Johnson, *supra* note 13, at 45. Given the emotion and awareness stirred by the Thomas hearings and their aftermath, such identity and drive should be more prevalent.

196. FED. R. CIV. P. 23(b)(1).

197. FED. R. CIV. P. 23(b)(2).

198. FED. R. CIV. P. 23(b)(3).

199. *Id.*

200. While in *quid pro quo* cases there may be an individual interest due to the different intensity of the harassment, a member exposed to the same hostile environment would likely have less interest in individual control and hope for a better outcome with class proof since courts assess frequency of harassment to determine pervasiveness.

because records would likely be available as to the whereabouts of employees or ex-employees. And, because the size of the class remains relatively small in most hostile environment cases, notice would not be an insurmountable challenge. In cases where notice is required, it has generally been for those members that could be identified, with defendants required to provide necessary address lists.[201]

While most Title VII cases are certified under 23(b)(2) because of the predominant need for injunctive remedies, the rules allow certification under both subsections for different parts of the case, i.e., the equitable portion and the damages portion.[202] Indeed, a proposed amendment to the Federal Rules of Civil Procedure suggested combining the subsections and treating them as factors in deciding whether a class action is a superior method of adjudication.[203]

IV. Hostile Environment Class Actions are Desirable and Effective

Given the foregoing, class certification in these cases is appropriate and, in any case, is left to the discretion of the court.[204] What remains to be determined is whether such a procedural strategy is desirable from the standpoint of meeting the goals of Title VII. This Note suggests that it is, and that such an approach would provide an adequate deterrent, would compensate victims, would encourage more plaintiffs to come forward to represent their peers, would have a greater financial impact on companies, and therefore would motivate institution of stronger, proactive, anti-harassment policies and procedures, and more efficient complaint mechanisms. Most significantly, the use of class actions could provide a collective voice for women, one loud enough to outshout the cacophonous clatter of offensive work environments.

A. Class Actions Would Encourage and Allow More Women to Bring Hostile Environment Claims

One of the most important outcomes of applying a class action strategy to hostile environment claims is the strong possibility that it would secure relief for a greater number of victims.

Fear of retaliation is a strong disincentive to women considering the filing of a claim against their employer alleging harassment in the workplace.[205] The

---

201. Legal Services Manual for Title VII Litigation at 31 (Rev. Oct. 1975) National Employment Law Project. *See also* Arey v. Providence Hosp., 55 F.R.D. 62 (D.C. 1972); Ostapowicz v. Johnson Bronze Co., 54 F.R.D. 465 (W.D. Pa. 1972).

202. 15 Class Action Reporter 27.

203. *Id.* at 21 (Amendments proposed by the Advisory Committee on Civil Rules of the Judicial Conference).

204. Rossini v. Ogilvy & Mather, Inc., 798 F.2d 590, 594 (2d Cir. 1986).

205. Comments of Marcia Greenberger, of the National Women's Law Center, in *Federal*

lingering and largely accurate perception that pursuing individual claims will invite reprisal or retaliation can be a powerful deterrent to women, forcing many to keep their mouths shut and their sexual harassment claims unfiled.[206]

Certification of a class action would serve to protect participation in the action.[207] While in a perfect world, legal and otherwise, those harmed would be able to come forward freely with their claims,[208] that is not always the case. Many women are afraid to complain, not wanting to be seen as troublemakers, and are intimidated by possible repercussions.[209] Woman often are forced to endure an abusive environment or risk losing job, salary or livelihood,[210] all on the basis of a lawsuit whose outcome she cannot guarantee.[211] It is well-recognized, and perhaps was even re-emphasized by the Thomas hearings, that it takes great courage and stamina to proceed with claims.[212]

Since one of the barriers to bringing sexual harassment charges is the unappealing prospect of being a one-woman "David" against a corporate "Goliath," only the heartiest of women[213] may be willing to undertake such a seemingly futile battle and risk an unfavorable outcome.[214] The Thomas-Hill hearings may have sent a mixed message to women,[215] and even had a

---

Judge Grants Class Action Treatment to Sex Harassment Claim Against Mining Company, 244 DAILY LABOR REPORT A-10 (1991).

206. Most or all of the plaintiffs in *Slanina* would have been hesitant to participate if joinder had been required. Slanina v. William Penn Parking Corp., 106 F.R.D. 419, 424 (M.D. Pa. 1984).

207. *Id. See also* Conte, *supra* note 113, at 18, suggesting the use of class actions shields against the retaliatory conduct that is common in sexual harassment cases.

208. *See* § 704 which prohibits employers from retaliating against complaining employees. Title VII of the 1964 Civil Rights Act, § 704, 42 U.S.C. § 2000e-3(a) (1982).

209. Claire Safran, *supra* note 27, at 219.

210. Workers filing claims often encounter retaliatory discharge, demotions, ostracisms by co-workers, and even "black-listing" by employers in a particular field or industry. House Report, *supra* note 20, at 71.

211. "Even if [women] recognize themselves as victims of sexual harassment, many perceive bringing it out into the open will only backfire on her." James Gruber, University of Michigan sociologist and workplace harassment authority in Leslie Dreyfous, *Women in Workplace Coming Forward after Thomas Allegations*, MPLS. STAR TRIBUNE, Oct. 10, 1991, at 8A.

212. Victor Schacter suggested the paradox of the response to the hearings: although there was greater awareness generated by Hill's testimony, since Thomas was ultimately successful, some women may have drawn the conclusion that it is just not worth the trouble. *Thomas Hearings, supra* note 8, at 1464.

213. Protest requires a "quality of inner resolve that is reckless and serene, a sense of 'this I won't take' that is both desperate and principled." MACKINNON, *supra* note 15, at 53. Especially in a tough economic climate where women are in many cases the breadwinner for their families, such resolve is rare.

214. One of Packwood's accuser's said "I'm really afraid we'll go through with all this, then if nothing happens, or virtually nothing happens, we have actually harmed other women by becoming an illustration of how hard it is to challenge this." Margasak, *supra* note 1, at A-2.

215. *Thomas Hearings, supra* note 8, at 1464.

"chilling" effect on the desire to bring suits. It is that image of a sole female pitted against the pomposity of a panel of unaffected men that provided for some women the most poignant—and most powerful—image of the Thomas hearings.[216] That scenario of one woman "going it alone," stands in sharp contrast to the image of a suit brought on behalf of a group of aggrieved colleagues. With a class behind her claim, one woman's whispered word against the world is amplified by the resonant voices of her co-workers.

Class actions will serve to remove some of the obstacles to filing charges or at least minimize or spread them across the class. Class actions also can help spread the cost of litigation.[217] If the *Meritor* decision was expected to fuel an increased number of claims,[218] then certainly the now greater awareness and the opportunity to commune as a class[219] will have a similar motivating effect on women. Moreover, as greater numbers of woman have their sexual harassment claims adjudicated, even more legitimacy will be associated with such claims.

The class action also offers maximum protection for plaintiffs and makes it easier for them to bring suit. While an employment discrimination action can generally only be certified as a class action to the extent of the named plaintiff's EEOC charge,[220] courts have encouraged liberal interpretation, taking into consideration that such charges are filed by laywomen and allowing the class complaint to include all claims which could reasonably be expected to grow out of the charge of discrimination.[221] This provides the opportunity for class certification of a claim which, when the EEOC charge was originally filed by the named plaintiff, might not have included other discriminatory factors.[222] Such flexibility would allow women not originally contemplating the use of class action to broaden the complaint to include other discriminatory acts.

A prospective class member would have little incentive to opt out if the case were brought as a 23(b)(3) class action. Even if the employer is found not to have engaged in a general pattern or practice of discrimination, a class

---

216. "Hill's allegations and accusations that the [Senate] Judiciary Committee failed properly to investigate them, have brought to a boil anger about sexual harassment--and the silence that reinforces it." Leslie Dreyfous, *supra* note 211, at 8A.

217. *Developments in the Law—Class Actions*, 89 HARV. L. REV. 1318, 1578-80 (1976).

218. Cook, *The New Bias Battleground: Sex Harassment*, NAT'L L.J., July 7, 1986, at 11, col 3 (suggesting that the *Meritor* ruling should make women feel more comfortable about bringing suit).

219. Women may be more likely to file claims because "they feel less alone," and employers are getting more aggressive with policies and letting people know complaint routes, per Judith Vladeck. *Thomas Hearings, supra* note 8, at 1464.

220. *See* Kloos v. Carter-Day Co., 799 F.2d 397, 400 (8th Cir. 1986).

221. *See* Griffin v. Carlin, 755 F.2d 1516, 1522 (11th Cir. 1985).

222. Lois Jenson's original EEOC charges described only incidents of sexual harassment, but the court allowed an expansion of those claims in the class suit. Jenson v. Eveleth Taconite Co., 139 F.R.D. 657, 666 n.30 (D. Minn. 1991).

member can still maintain a civil action alleging an individual claim of discrimination.[223] Thus, an employee would have little to lose by remaining a member of the class. If a *general* practice of discrimination were not found, still available to her would be the opportunity to litigate charges of discrimination against her as an *individual*. Thus, the rationale that restrictive application of Rule 23 requirements are mandated by the *res judicata* effect of adverse determination is largely a theoretical argument.

Since the scope of Federal Court inquiry is limited to the scope of the EEOC investigation or some reasonable derivation from the EEOC charge,[224] complainants considering class action treatment will likely be advised to challenge a wide range of employment practices. This may intensify the pressure on employers to avoid "simple" harassment, realizing that full-blown discrimination suits can grow from those charges.

B. Class Actions Would Allow More Hostile Environment Plaintiffs to Prevail

The use of class actions, though a procedural strategy, could mean more successful sexual harassment suits. In many cases, sexual harassment claims have failed when an accuser's credibility has been questioned due to lack of corroborating evidence. Sexual harassment claimants have had difficulty convincing co-workers to testify.[225]

A pattern of harassment generally contributes to a stronger hostile environment claim than an isolated incident.[226] Even where individual plaintiffs could not prove harassment, it has been acknowledged that sexually harassing incidents reported by other female employees could be "relevant in a class action suit."[227] That the number of incidents required for severity is inversely related to the offensiveness of the event would suggest that a large group of women harassed on a classwide and regular basis would provide the required indicia of severity.[228] Harassment of more than one woman is found as strong evidence that such harassment occurred.[229] The greater the quantity of harassing incidents, the less egregious each of them has to be.

---

223. *See* Cooper v. Federal Reserve Bank of Richmond, 467 U.S. 867 (1984).

224. *See* Sanchez v. Standard Brands, Inc., 431 F.2d 455 (5th Cir. 1970).

225. MACKINNON, *supra* note 15, at 20.

226. EEOC: Policy Guidelines on Sexual Harassment, 8 Fair Employment Practices Manual (BNA) 405: 6681, 6690 (Mar. 19, 1990).

227. Jones v. Flagship Int'l, 793 F.2d 714, 720 (5th Cir. 1986) (suggesting relevance to class actions of testimony about incidents involving other employees).

228. *See generally Sexual Harassment Claims of Abusive Work Environment Under Title VII*, *supra* note 138, at 1454-59.

229. MACKINNON, *supra* note 15, at 26. *See also* Pease v. Alford Photo Indus., Inc., 667 F. Supp. 1188 (W.D. Tenn. 1987) (supporting testimony of co-workers was an important factor in finding of hostile environment). And, the more severe or pervasive the hostility is, the more likely it is that a number of employees can qualify as class members.

Where a woman might have lacked evidence of the pervasiveness of the actions, her representation of a class of similarly situated, similarly harassed colleagues would offer convincing evidence of the frequency and quantity of occurrences. This collective accusation would contrast to the bringing of individual suits, where those asked to testify had little to gain personally, and much to lose, especially if they were still employed in and subjected to the harassing environment.

Fear of retaliation, thinking no one will believe them or that they will not be taken seriously, and a desire not to see the harasser punished are all reasons women do not report harassment.[230] Class action certification would offer a buffer of protection from retaliation and would provide the charges with a level of seriousness and respectability that a sole claimant could not collect or conjure.

To the extent courts correctly believe the reasonable person standard trivializes concerns of women, the reasonable woman standard should result in a finding of liability in a broader array of situations than the previous standards.[231] This could contribute to the success of class actions in cases where courts employ the reasonable woman test.

Many women have quit their jobs rather than endure an abusive environment; this leads to continued victimization of others and contributes to the lack of visibility of the problem.[232] Class actions could provide some better visibility. While a decision rendered about one woman's reality can be important, as it was in the case of Anita Hill's testimony, one that suggests that numerous females in a corporation have been involved will certainly have greater ramifications.

C. The Use of Class Actions for Hostile Environment Discrimination Claims Will Create a Greater Financial Impact on Employers and Motivate Stronger Anti-Harassment Policies

With or without class actions, an increase in suits based on various forms of discrimination, including gender, are expected during the next decade.[233] Just as the lack of monetary damages removed incentive for plaintiffs to bring sexual harassment suits, the minimal financial consequences may have also

---

230. Anita Hill speaking at a forum of human resources executives on October 12, 1992. 30 GOV'T EMPL. REL. REP. (BNA) 1404 (1992).

231. *Special Study, Sexual Harassment in the Workplace*, Research Institute of America at 11 (July 1991).

232. Elaine Frost, *Sexual Harassment in the Workplace*, 71 WOMAN LAWYERS JOURNAL 19 (1985).

233. *Six Major Areas of Litigation Predicted for the 1990s*, 3 Inside Litigation 32 (P-H) (Mar. 1992).

discouraged employers from taking stronger remedial action to "clean up their acts"—and their hostile environments.[234]

If money talks about the need to take strong action to prevent sexual harassment in the workplace, it will speak even more loudly and more articulately through the class.[235] Making employers liable for losses will deter future acts, not only for that specific employer but will also serve as a general example to others in the industry.[236] The increased financial liability expected due to the compensatory and punitive damages provisions of the Civil Rights Act of 1991 will create a powerful deterrent force.[237] Factoring in the multiplier effect of class actions on employer liability will serve to intensify the deterrent effect of monetary damages.[238] Even given new remedies, if damages are limited only to a single victim, the impact on a business of a verdict for the plaintiff is, in the big picture, insignificant. When that verdict[239] is multiplied by 20 or 100 or 1000, the impact, the incentive and the urgency are likewise multiplied; the bottom line, sorely effected; the point, clearly made. Regardless of outcome, the litigation itself is expensive.[240]

D. Class Actions are an Efficient Way of Dealing with Expected, Increased Litigation

The rapid growth in employment discrimination litigation in the years since Title VII went into effect has raised concern that such cases impose a significant burden on federal judges.[241] Racial and sexual harassment claims

---

234. "If [the employer] faced only the prospect of an injunctive order, they would have little incentive to shun practices of dubious legality." Albemarle Paper Co. v. Moody, 422 U.S. 405, 417 (1975).

235. "If discrimination costs money, people will stop doing it." Dr. Heidi Hartman, testifying before House Committee. House Report, *supra* note 20, at 70.

236. "The damages a plaintiff recovers contribute significantly to the deterrent of civil rights violations in the future." Riverside v. Rivera, 477 U.S. 561, 575 (1986).

237. Data suggest that perception of increased liability causes employers to take action to interrupt and prevent employment discrimination. House Report, *supra* note 20, at 70. While damages will unlikely make a plaintiff whole (unfortunately, even most successful plaintiffs end up leaving the defendant's employ) they can serve as a deterrent to future harassment of others. House Report, *supra* note 20, at 70 (1990 Hearing, Vol. 2 at 180-181).

238. Wende Farrow, of the Minneapolis based Employer Association, a human resource consulting firm, suggests that with the new damages provision of the Civil Rights Act of 1991, the class action has great implications for employers. "If employers need to have a strong legal message to get them to take the action, you're not going to probably get one that's stronger." *Morning Edition* (National Public Radio broadcast Aug. 13, 1992) (available in LEXIS, NEXIS library NPR file).

239. Punitive damages are available up to $300,000 from large employers. 42 U.S.C §1981 9(a) and (b) (Supp II 1992). And, since each individual is entitled to the maximum amount of damages under Title VII, class actions can result in six or seven figure damages awards.

240. *See Alternative Dispute Resolution, supra* note 9, at A-15.

241. John J. Donohue III and Peter Siegelman, *The Changing Nature of Employment Discrimination Litigation*, 43 STAN. L. REV. 983, May 1991 (citing Federal Courts Study

represent a growing percentage of civil rights litigation under Title VII.[242] This burden could be alleviated by greater use of class action lawsuits for sexual harassment. Proof of many of the elements of the claims made by women in a single workplace environment would be identical whether taken individually or as a class, and much of the same evidence would be used.[243] To disallow class actions and by so doing insist that a series of repetitive claims be brought by a variety of different plaintiffs against a single employer would be highly unproductive, from the point of view of the courts and the employer.[244] While this "parade" of individual hostile environment suits may not yet have occurred, due to the small percentage of claims made,[245] the new awareness and increased damages may significantly and quickly lengthen that queue.

Another administrative efficiency would result from the fact that only the named plaintiff need exhaust the EEOC administrative process prior to filing a Title VII class action suit.[246] Thus, a matter of workplace hostility could be investigated and litigated without the separate filing of dozens or hundreds of separate, but essentially equal, EEOC complaints.[247] Although individuals may be excluded from the class for not filing charges with the EEOC because the statute of limitations had run by the time the class charge was filed,[248] such exclusions are procedural, not philosophical, and not abundant enough to disturb the premise that class actions are legally proper. Also, the EEOC is authorized to bring an action against an employer on behalf of a class in its own name, without meeting Rule 23 requirements so long as the allegations grew out of the EEOC investigation.[249]

E. The Use of Class Actions to Litigate Hostile Environment Claims Supports the Remedial Nature of Title VII

The goal of Title VII is eliminating discrimination in the workplace.[250] Congress intended this would be accomplished by "the removal of artificial,

---

Committee, Tentative Recommendations for Public Comment 49-50 (1989) (noting increase in cases)).

242. CHI. DAILY L. BULL., Oct. 31, 1991, p. 3, col. 3.

243. *See, e.g.*, Jenson v. Eveleth Taconite Co., 139 F.R.D. 657, 665 (D. Minn. 1991).

244. Johnson, *supra* note 13, at 61.

245. *See supra* notes 26-27 and accompanying text.

246. CONTE, *supra* note 92, at 163.

247. Requiring every employee to file an EEOC charge would "frustrate our system of justice and order." Oatis v Crown Zellerbach Corp., 398 F.2d 496, 499 (5th Cir. 1968). "It would be wasteful if not vain, for numerous employees, all with the same grievance, to . . . process identical complaints with the EEOC." *Id.* at 498.

248. Wetzel v. Liberty Mut. Ins. Co., 508 F.2d 239, 246 (3rd Cir. 1975).

249. 42 U.S.C. § 2000e-5(f)(1). *See also* Donohue and Siegelman, *supra* note 241, at 988.

250. *See* Griggs v. Duke Power Co., 401 U.S. 424 (1971).

arbitrary and unnecessary barriers to employment."[251] The Civil Rights Act of 1991 was enacted to "strengthen and improve Federal civil rights law[252] because Congress had found that additional remedies were needed to deter unlawful harassment and intentional discrimination in the workplace."[253] Thus, the remedial purpose of Title VII legislation[254] suggests the need for an approach to these cases that will have significant, and prompt, impact on reducing sexual harassment overall.[255] The enforcement of Title VII actions necessarily depends on the ability of individuals to present their grievances without the threat of retaliatory conduct by their employers,[256] and class actions would dissuade employers from retaliation against any single employee. Also contrary to the intent of Title VII is restrictive application of the commonality and typicality requirements.[257] The class action has been an important enforcer of Title VII's promise to eliminate discrimination from the workplace. "Without [a class action's] efficiency and economy . . . the injury of thousands would have remained undiscovered and unredressed."[258]

The use of class actions to protect women from being discriminated against in the workplace may have broader, positive social impact. "By informing people that the expression of racist or sexist attitudes in public is unacceptable, people may eventually learn that such views are undesirable in private as well. Thus Title VII may advance the goal of eliminating prejudices and biases in our society."[259] Such a lofty goal, certainly not attainable on the legal force of Title VII alone, is less likely to be met by one plaintiff at a time. A class action, which addresses and redresses the wrongs of groups of women, would more effectively "inform" people of the unacceptability of sexist views.

---

251. Andrews v. City of Philadelphia, 895 F.2d 1469, 1470 (3d Cir. 1990) (citing *Griggs*, 401 U.S. 424).

252. P. L. 102-166 [S. 1745] *reprinted in* 1991 U.S. Code Cong. and Adm. News, 105 Stat. 1071.

253. *Id.* This redundancy in wording should not be interpreted to infer that unlawful harassment is *not* intentional discrimination. Rather, it expresses a desire to explicitly recognize the dangers of harassment being covered by the Act and to place them on equal footing with the more prominent methods of discrimination.

254. The "remedial and humanitarian underpinnings" of Title VII should be considered in not allowing procedural technicalities to bar claims under this act. Sanzchez v. Standard Brands, Inc., 431 F.2d 455, 560 (5th Cir. 1970).

255. "Class actions are a necessary tool to vindicate Title VII rights." *See* Johnson, *supra* note 13, at 3.

256. *See, e.g.,* Jones v. Flagship Int'l, 793 F.2d 714, 726 (5th Cir. 1986).

257. Excessive demands of identical interest will serve to defeat certification and, thus, the policy and remedial purposes of Title VII. Johnson, *supra* note 13, at 39. "[I]f our nation is to move with speed toward genuine equality of opportunity, employers . . . cannot be allowed to escape the requirements of Title VII by a litigation strategy of divide and conquer." *Id.* at 40 (citing Cook v. Boorstin, 763 F.2d 1462, 1472 (D.C. Cir. 1985)).

258. Johnson, *supra* note 13, at 62.

259. Davis v. Monsanto Chem. Co., 858 F. 2d 345, 350 (6th Cir. 1988).

As with any type of classwide relief, there will likely be some marching out of monsters, the demons of unreasonable damage awards,[260] frivolous litigation,[261] or the horror of unharmed women receiving damages because the behavior in question did not affect or impact them as it did the rest of the class.[262] Adherence to a reasonable woman standard in the liability phase of a class claim does not determine whether each individual woman was harmed, but whether a reasonable woman would find the environment abusive. This standard protects employers from liability for exposing *ultrasensitive* employees to a hostile environment, but it also requires that they be responsible for hostility toward *insensitive* employees. An isolated incident of a woman who is found to have been exposed to a hostile environment although she is not consciously offended by the hostility that surrounds her should not prevent the many hundred or thousands of others from making use of their legal rights to take classwide action to stop such hostility. The harm done may not be cognizable to the individual woman but rather is made manifest in the long term inferiority, lack of respect and power, and damage to self-concept that such harassment engenders.

Most victims lack the means, the legal know-how, the access and the energy to be frivolous in their pursuits.[263] And no floodgate of litigation has been swept open by the availability of similar damages for racial discrimination.[264] The fears of fostering unnecessary litigation, disproportionate jury awards, or discouraging claim settlement and conciliation are not founded in fact or previous Title VII experience.[265]

---

260. There is no merit to statement that adding a damages remedy will cause jury awards disproportionate to the offense committed or injury sustained. House Report, *supra* note 20, at 72. For example, an analysis of damage award under Section 1981 shows that between 1980 and 1990, compensatory and punitive damages were awarded in only 69 of 594 section 1981 cases. In two thirds of these, the award was $50,000 or less, and the award only exceeded $200,00 in four cases. *Id.* (citing Shea & Gardner, *Analysis of Damage Awards under Section 1981* (Jan. 23 1991)).

261. Suing an employer is an undertaking with personal and professional ramifications. House Report, *supra* note 20, at 71. Also, since most plaintiff's attorneys in these cases get paid only if they win, they are unlikely to pursue claims without merit.

262. This fear is unfounded. A victim must "subjectively perceive the environment to be abusive" for Title VII damages to be awarded. *Harris*, 114 S. Ct. 367, 370 (1993). A finding of liability in a class action only establishes the hostility of the environment; no remedy is available to a class member unless she is subjectively, negatively affected. Jenson v. Eveleth Taconite Co., 824 F. Supp. 847, 876 (D. Minn. 1993).

263. Nancy Ezold, testifying at the 1990 Hearings (Vol. 2, at 191) suggested that there are enormous obligations and costs to the plaintiff, in terms of time and trial. She cited the huge financial burden on a plaintiff that a corporation does not equally bear. House Report, *supra* note 20, at 71.

264. House Report, *supra* note 20, at 71 (compensatory and punitive damages have long been available under Section 1981 for racial discrimination with no evidence that an inordinate number of frivolous lawsuits have been filed).

265. *See* House Report, *supra* note 20, at 71-73. And, in any event the burden of proving that she was harmed remains on the individual during the recovery phase. Prior to that showing,

V. CONCLUSION

The stage is set: increased awareness due, in large part, to the Thomas confirmation hearings (but brewing for years before in the "undiscovered and unredressed"[266] injury of millions of women in the workplace); expanded remedies in the form of compensatory and punitive damages provided by the Civil Rights Act of 1991; and the class certification[267] and eventual success[268] of a hostile environment claim in *Jenson v. Eveleth Taconite Co.* Even with strict adherence to the Rule 23 requirements, many hostile environment claims, whether brought alone or as part of an across the board charge of discrimination, have the potential for class certification. The threat of retaliation and resultant fear of joinder will assure the meeting of numerosity in many cases; the application of the reasonable woman standard will often provide the requisite commonality and typicality; and the growing numbers, new interest and renewed strength of working women is likely to encourage more plaintiffs to come forward as adequate representatives.

Whether the curtain rises on a proliferation of class action suits will depend in part on the employer's level of proactive earnestness in dealing with sexual harassment and the judicial response to future requests for class action certification in hostile environment cases. Some may argue that class claims for hostile environments will make employers liable even to women who are not offended or affected by the environment; however, one must consider that, just as super-sensitive plaintiffs cannot easily seek recovery under the reasonable woman theory, women who are unreasonably *un*affected, or perhaps acculturated or afraid to be affected, by patently offensive and sexually degrading environments will also not defeat the legitimate claims of the majority of reasonable women. There is no cost of injunctive relief for these unaffected women, and the cost of damages is far less than that expended to hire and train the thousands of reasonable women whose work environments are poisoned and whose job status is impacted, however subtly or long term, by harassing and abusive environments.[269]

Morality and justice aside, adequate practical forces and business wisdom speak against allowing sexual harassment. Employers need to consider the cost savings to be realized by eliminating harassing behavior. Strenuous

---

she is only eligible for appropriate prospective relief consistent with a finding of liability. *Jenson*, 824 F. Supp. at 875.

266. *See supra* note 258 and accompanying text.

267. Jenson v. Eveleth Taconite Co., 139 F.R.D. 657 (D. Minn. 1991).

268. Jenson v. Eveleth Taconite Co., 824 F. Supp. 847 (D. Minn. 1993).

269. The fiscal impact of harassment is great. It has been estimated that the total costs for replacing an employee often exceeds the salary; the Employee Management Association estimates that it costs almost $8000 to recruit and hire an exempt employee. Lost productivity due to low morale and turnover are even more expensive. JANA HOWARD CAREY, SEXUAL HARASSMENT IN THE WORKPLACE, 426 PLI Lit. 30 (1992)

efforts to protect vulgar speech, pornography, and sexual epitaphs are counterproductive and have not been proven to positively impact on the productivity of men or women. Harassment is time consuming, and certainly not focused on the important work at hand. Non-work related chatter and the time taken to post pornography are certainly unnecessary expenses that employers could eliminate, while at the same time preventing costly and embarrassing harassment suits.

Prior to the *Jenson* case, such sexual harassment suits had been brought only by individuals.[270] Those individual suits have been traditionally difficult to prove, sometimes because of the unwillingness of female colleagues and co-workers to corroborate the accusations. It may be that the comfort—and power—of class certification will convince women that they are not alone and will reapportion the energy acknowledgedly needed to endure and survive harassment litigation. In a class action, where all those affected stand to benefit equally, women formerly concerned about ending up on the winning side may be motivated to reassess their loyalties and recalculate their odds for a positive outcome. Allowing suits to now be brought on behalf of *all* women exposed to the same hostile environment raises new questions that will only be answered by the judicial response to future requests for class certification.

Careful, legally appropriate use of class actions should provide employers with a powerful incentive to eradicate hostile behavior from their workplaces. The class action procedure provides women with the muscle to gently shift the balance of power, by forcing relocation of the fulcrum to accommodate the weight of multiple female plaintiffs. While class actions are neither a panacea, nor appropriate in every sexual harassment situation, they do offer the promise of strengthening Title VII's remedial scheme and, if not providing women with an ultimately "powerful new tool,"[271] at least providing an articulate and much needed voice to many of those who now suffer in silence.

---

270. "To the court's knowledge no class of plaintiffs has ever maintained through trial a claim of sexual harassment." *Jenson*, 824 F. Supp. 847, at 875.

271. According to Jenson's lawyer, the certification "represents a major breakthrough that will give all women faced with sexual harassment in the workplace a powerful new tool in future cases." *Judge Rules Lawsuit on Sex Harassment can be Class Action*, N.Y. TIMES, Dec. 19, 1991, at B17.

The Guides To The Evaluation of Permanent Impairment and Workers' Compensation in Indiana

Charles Richard O'Keefe, Jr.*

Introduction

Workers' compensation systems across the country are under severe strain.[1] The cost of medical care under workers' compensation has skyrocketed. From 1985 through 1989, general health care expenditures increased by 43.8% while health care expenditures for workers' compensation increased by 79.2%, almost twice as fast.[2] Fraud has infected many systems. Experts believe that as many as twenty percent of all claims are fraudulent.[3] Increased litigation is having a disastrous impact on costs and is diverting an alarming proportion of benefit dollars away from injured workers in some systems.[4] Further, employee advocates and other groups have continued to push for expansion of workers' compensation laws to cover a continuously growing list of injuries and illnesses connected to workplace activity.[5]

State legislatures have reacted to these pressures by repeatedly amending workers' compensation laws. Indiana recently amended its Workers' Compensation Act[6] ("Act") when Governor Evan Bayh signed House Enrolled Act 1517 into law on May 20, 1991.[7] The new law introduced many significant changes to the Act, especially with respect to the permanent partial

---

* J.D. Candidate, 1994, Indiana University School of Law—Indianapolis; B.A. Economics 1985, Beloit College; B.A. Government 1985, Beloit College.

1. Ira Magaziner, President Clinton's Chief Policy Development Adviser, said at a recent meeting of the National Association of Manufacturers that "[t]he only thing worse than health insurance is workers' compensation. It's a mess. It's full of fraud and abuse and has huge adjudication costs." Mary Jane Fisher, *Auto, WC Figuring Into Clinton Plan*, Nat'l Underwriter, May 17, 1993, at 54.

2. Ruth Gastel, *Workers Compensation*, Ins. Info. Inst. Rep., Oct. 1992, at *2, *available in* LEXIS, COMPANY Library, IIABS File.

3. Peter Kerr, *Vast Amount of Fraud Discovered In Workers' Compensation System*, N.Y. Times, Dec. 29, 1991, at A1.

4. Gastel, *supra* note 2, at *3.

> In California, for example, despite recent reforms, many cases, particularly stress-related claims, still are litigated. Statewide, the overall litigation rate reached a record 13.8 percent of total new claims reported during the second quarter of 1991, up 17 percent from 1989. . . . A study of more than 1,000 claims settled in Kansas found that lawyers were involved in more than 70 percent of the cases. . . . Massachusetts is yet another state where costs have been driven up by litigation. Lawyers representing claimants made $86.6 million in fees in 1990, according to the state's Industrial Accident Board.

5. Gastel, *supra* note 2, at *7.

6. Ind. Code § 22-3-1-1 to -12-5 (1988 & Supp. 1992).

7. Act of May 12, 1991, Pub. L. No. 170-1991, 1991 Ind. Acts 2426.

benefit scheme,[8] which is one of the most complex and controversial aspects of any workers' compensation system.[9]

This Note examines Indiana's permanent partial benefit scheme and, specifically, the role played by the *American Medical Association Guides to the Evaluation of Permanent Impairment* ("*Guides*")[10] in determining an injured workers' level of permanent partial impairment. Part I begins the examination by briefly describing the origins of workers' compensation laws and the basic forms of compensation available to an injured worker in Indiana. Part II provides a brief general history and analysis of the permanent partial benefit and the theories which underlie its payment. Part III describes the permanent partial benefit in Indiana and how it was modified by House Enrolled Act 1517. Part IV then describes the role of the *Guides* in the rating process, addresses criticisms of its use as a tool to rate permanent partial impairment, and concludes that the use of the *Guides* should be mandated in Indiana.

I. Origins And Forms Of Compensation

A. The Origins of Workers' Compensation Laws

At common law, the only way employees could recover for workplace injuries was to sue their employers for negligence.[11] Employers, however, had many powerful defenses at their disposal, including fellow servant fault, employee assumption of risk, and contributory negligence by the employee, which often precluded the employee from recovering damages.[12]

During the 19th century, the industrial base in the United States increased dramatically. This expansion was accompanied by a significant increase in workplace accidents and injuries. Common law recovery was time consuming, costly, and often resulted in employees and their families being denied compensation.[13] The "grossest deficiencies and inequities of the common law led to employers' liability laws, which restricted the employer's legal

---

8. Permanent partial benefits are those benefits which are paid to an injured worker when he sustains an injury that reduces his mental or physical capabilities. *See infra* note 41 and accompanying text.

9. Nat'l Comm'n on State Workmen's Compensation Laws, Report of the Nat'l Comm'n on State Workmen's Compensation Laws 66 (1972).

10. American Medical Association, Guides to the Evaluation of Permanent Impairment (4th ed. 1993) [hereinafter Guides].

11. Gastel, *supra* note 2, at *7.

12. Eliza K. Pavalko, *State Timing of Policy Adoption: Workmen's Compensation in the United States, 1909-1929*, 95 Am. J. of Soc. 592, 593 (1989).

13. *See* Nat'l Comm'n on State Workmen's Compensation Laws, *supra* note 9, at 34.

defenses."[14] Under these laws, however, employees were still required to prove employer negligence.[15]

As an alternative to employer liability laws, workers' compensation statutes began to emerge in the United States in the early 1900's. The first workers' compensation law was enacted in New York in 1910, but was held unconstitutional the following year.[16] As a result of New York's efforts, ten states, led by Wisconsin, enacted workers' compensation laws in 1911.[17] By 1949, every state had enacted some form of workers' compensation legislation.[18]

Indiana's workers' compensation law can be traced to July 7, 1909 when Mr. Addison C. Harris presented a paper to the Indiana State Bar Association entitled, "Modern Views of Compensation for Personal Injuries."[19] The paper described the plight of injured workers and urged Indiana lawyers to consider reform of the law dealing with workplace injuries.[20] The State Bar Association subsequently began drafting a workers' compensation plan to present to the Indiana General Assembly.[21] From 1909 through 1912 the Association wrestled with this issue, and later joined with the General Assembly to produce Indiana's first workers' compensation legislation, entitled the 1915 Workmen's Compensation Act.[22]

The current Indiana Worker's Compensation Act, as well as all other workers' compensation laws, reflects a compromise struck by employers and injured workers. An employer is obligated to provide limited compensation to workers whose injuries and illnesses arise out of and in the course of his employment, regardless of fault.[23] Workers who were previously precluded from recovery under common law theories are thus guaranteed compensation. In exchange, an injured worker relinquishes the right to sue his employer for negligence,[24] and an employer's liability is thereby reduced. The scheme is

---

14. *Id.*
15. *Id.*
16. BEN F. SMALL, WORKMEN'S COMPENSATION LAW OF INDIANA § 1.2, at 5 (1950) (citing Ives v. S. Buffalo R. Co., 94 N.E. 431 (N.Y. 1911) (rejecting the idea of liability without fault)).
17. *Id.*
18. *Id.*
19. *Id.* at 6.
20. *Id.*
21. *Id.* at 7.
22. *Id.*
23. Collins v. Day, 604 N.E.2d 647, 648 (Ind. Ct. App. 1992).
24. Gastel, *supra* note 2, at *6. The exclusiveness of workers' compensation as the injured workers' sole remedy is often provided by statute. The Indiana Act provides:

> The rights and remedies granted to an employee subject to IC 22-3-2 through IC 22-3-6 on account of personal injury or death by accident shall exclude all other rights and remedies of such employee, the employee's personal representatives, dependents, or next of kin, at common law or otherwise, on account of such injury or death, except for

not based on notions of tort or contract law, but is instead social legislation designed to aid workers and their dependents[25] and "shift the economic burden for employment related injuries from the employee to the employer and consumers of its products."[26]

B. The Basic Forms of Compensation in Indiana

Most workers' compensation claims involve the payment of wage replacement and medical benefits for injuries or illnesses arising out of, and in the course of employment.[27] The balance of claims involve either the payment of a permanent total disability benefit or a permanent partial impairment benefit.

1. Wage Replacement.—Indiana law requires employers to pay wage replacement benefits and provides in part: "Compensation shall be allowed on account of injuries producing only temporary total disability to work or temporary partial disability to work."[28] The wage replacement benefit is payable to an injured worker for up to 500 weeks of disability or until the worker's medical condition becomes permanent and quiescent,[29] whichever occurs sooner.[30] The amount of the benefit depends on the worker's average weekly wage over the year preceding the date of the accident,[31] subject to maximum wage levels set forth in the Act.[32]

---

remedies available under IC 12-8-6."

IND. CODE § 22-3-2-6 (Supp. 1992).

25. SMALL, *supra* note 16, § 1.2, at 2-3.

26. *Collins*, 604 N.E.2d at 648.

27. The phrases "arising out of" and "in the course of" are often the source of much controversy under the Act. These phrases emanate from the Act, which provides that employers and employees are "to pay and accept compensation for personal injury or death by accident *arising out of and in the course of* the employment." IND. CODE § 22-3-2-2 (Supp. 1992). "Arising out of" refers to the origin or cause of the accident and "in the course of" pertains to the time, place, and circumstances surrounding the accident. *See, e.g.*, Tom Joyce 7 Up Co. v. Layman, 44 N.E.2d 998, 999-1000 (Ind. Ct. App. 1942).

28. IND. CODE § 22-3-3-7(a) (Supp. 1992). Subsection (a) reads in its entirety as follows:

> Compensation shall be allowed on account of injuries producing only temporary total disability to work or temporary partial disability to work beginning with the eighth (8th) day of such disability except for medical benefits provided in section 4 [22-3-3-4] of the chapter. Compensation shall be allowed for the first seven [7] calendar days only if the disability continues for longer than twenty-one [21] days.

29. *See* Vantine v. Elkhart Brass Mfg. Co., 572 F. Supp. 636, 644-45 (N.D. Ind. 1983), *aff'd*, 762 F.2d 511 (7th Cir. 1985). If it is determined a worker's injury has become permanent and quiescent, and the employee has not fully recovered from his or her injury, the employee may be entitled to a permanent partial impairment benefit or a permanent total disability benefit. White v. Woolery Stone Co., 396 N.E.2d 137, 139 (Ind. Ct. App. 1979); *see also infra* Part III.B.

30. IND. CODE § 22-3-3-8 (1988).

31. *Id.*

32. IND. CODE § 22-3-3-22 (Supp. 1992).

The purpose of the wage replacement benefit is to provide injured workers with income during their disability from work.[33] The untoward circumstance of a disabling injury and the resulting discontinuance of income catches many workers without adequate means of support. Absent the immediate financial assistance provided by a wage replacement benefit, many workers would be in financial jeopardy during their recovery.

2. Medical Benefits.—The employer must also pay medical benefits to the injured worker. Indiana Code section 22-3-3-22 provides in pertinent part:

> After an injury and prior to an adjudication of permanent impairment, the employer shall furnish or cause to be furnished, free of charge to the employee, an attending physician for the treatment of his injuries, and in addition thereto such surgical, hospital and nursing services and supplies as the attending physician or the worker's compensation board may deem necessary.[34]

The liability of the employer for medical benefits is limited "to such charges as prevail in the same community for similar service to injured persons of like standard of living when such service is paid for by the injured person."[35] Neither the employee nor the employee's estate have any liability to a health care provider for payment for services obtained under the Act.[36] Claims for such services must be made against the employer and the employer's insurance carrier.[37]

Medical benefits are provided to ensure that injured workers are restored as nearly as possible to their pre-injury medical status, and also to assist in returning the injured worker to gainful employment as soon as possible.[38]

3. Permanent Total Disability.—A third basic form of compensation available to certain injured workers is the permanent total disability benefit. Indiana Code section 22-3-3-10(b)(3) provides that an employee shall receive 500 weeks of benefits at the employee's temporary total disability rate for

---

33. NAT'L COMM'N ON STATE WORKMAN'S COMPENSATION LAWS, COMPENDIUM ON WORKMEN'S COMPENSATION 24 (1972).

34. IND. CODE § 22-3-3-4(a) (Supp. 1992).

35. IND. CODE § 22-3-3-5 (Supp. 1992).

36. *Id.*

37. *Id.* Prior to amendment by House Enrolled Act 1517 in 1991, *see supra* note 7, medical providers were allowed to "balance bill" employees for the portion of medical services not paid by the insurance carrier or employer. Thus, medical charges were infrequently challenged and there was suspicion that charges under workers' compensation were inflated and the result of cost shifting. With the amendment, several insurance carriers and employers are now challenging the reasonableness of medical charges in an attempt to control their medical costs. Telephone Interview with Douglas Meagher, Executive Director, Indiana Worker's Compensation Board of Indiana (Sept. 14, 1993).

38. JOHN H. LEWIS, REPORT TO THE GOVERNOR, MAJOR ISSUES IN THE INDIANA WORKER'S COMPENSATION SYSTEM 27 (Dec. 1990).

injuries resulting in permanent total disability.[39] "To establish a 'permanent total disability', the workman is required to prove he or she 'cannot carry on reasonable types of employment.' The 'reasonableness' of the workman's opportunities are to be assessed 'by his physical and mental fitness for them and by their availability.'"[40]

4. Permanent Partial Benefit.—The fourth type of compensation available to an injured worker is the permanent partial impairment benefit. Simply put, this benefit is payable to any worker who sustains an injury that reduces his overall physical or mental capabilities.[41] The benefit is paid when the worker's physical condition is permanent and quiescent.[42] At the point of permanence and quiescence, temporary total disability benefits and medical benefits terminate.[43]

II. History and Underlying Theories of the Permanent Partial Benefit

Permanent partial benefit claims account for the majority of workers' compensation costs in most systems.[44] In Indiana, only 2.5% of all cases involve a permanent impairment, yet the cost of permanent partial impairment claims represent more than 50% of total system costs.[45] Permanent partial benefits are also the most controversial and complex aspect of workers' compensation.[46] No other class of benefits has produced more variation among states or more divergence between statutes and practices.[47]

An injured worker who returns to work may be entitled to a permanent partial benefit based on physical impairment alone, disability caused by the impairment, or some combination of the two concepts depending on the state's statutory scheme. Impairment and disability are not synonymous in workers' compensation systems, and it is important to distinguish between the two concepts. Impairment refers to an "anatomical, physiological, intellectual or emotional abnormality or loss."[48] Disability refers to "inability or limitations in performing social roles and activities such as in relation to work, family, or

---

39. Ind. Code § 22-3-3-10(b)(3) (Supp. 1992).

40. Rork v. Szabo Foods, 439 N.E.2d 1338, 1342 (Ind. 1982) (citations omitted).

41. Lewis, *supra* note 38, at 53.

42. *See infra* notes 102-03 and accompanying text.

43. *Id.*

44. Nat'l Comm'n on State Workmen's Compensation Laws, *supra* note 9, at 66.

45. Lewis, *supra* note 38, at 53. Permanent partial impairment benefits represent 27.3% of total system costs in Indiana. Individuals who receive permanent partial benefits however, also usually receive temporary disability and medical benefits, bringing the total cost of permanent partial cases to more than 50% of total system costs. *Id.*

46. Nat'l Comm'n on State Workmen's Compensation Laws, *supra* note 9, at 66.

47. *Id.*

48. Monroe Berkowitz & John F. Burton, Jr., Permanent Disability Benefits in Worker's Compensation 6 (1987) (citation omitted).

to independent community living."[49] Workers' compensation systems that award benefits on the basis of disability involve determinations of the economic consequences of the injury.[50] Alternatively, systems that award benefits on the basis of physical impairment do not consider the economic consequences of the injury and focus only on medical issues regarding the extent of the injury.[51] Disability and impairment represent the basic underpinnings of three theories for paying permanent partial benefits: (1) actual wage-loss; (2) permanent impairment; and (3) earning capacity loss.[52]

A. Actual Wage-Loss

The earliest workers' compensation statutes paid permanent partial benefits based on the actual wage-loss theory.[53] An actual wage-loss statute compares post-injury and pre-injury earnings and pays compensation for weeks in which actual post-injury earnings are less than pre-injury earnings.[54] Such a system has no scheduled losses.[55] Although the earliest workers' compensation laws employed an actual wage-loss rationale, no such system exists today in its pure form.[56]

Actual wage-loss systems were gradually eroded by certain changes in workers' compensation laws and practices, such as the introduction and expansion of scheduled losses.[57] The first statutes incorporating loss schedules appeared in 1912.[58] A schedule is a list of body members with a number of weeks of benefits assigned to each member for its loss or loss of use.[59] The early schedules were justified on two grounds: (1) "the gravity of the impairment supported a conclusive presumption that actual wage loss would sooner or later result; and (2) the conspicuousness of the loss guaranteed that awards could be made with no controversy whatever."[60] Initially, schedules were restricted to the loss or severance of major body members and did not cover partial loss or even total loss of use.[61] The schedules were gradually extended beyond major body members to cover smaller and smaller

---

49. *Id.* at 8 (citation omitted).
50. LEWIS, *supra* note 38, at 54.
51. ARTHUR LARSON, WORKMEN'S COMPENSATION § 57.14(a), at 10-69 to 10-70 (1986).
52. *Id.* While the theories for payment of permanent partial benefits are analytically discrete, most systems are comprised of some combination of the theories. LEWIS, *supra* note 38, at 57.
53. LARSON, *supra* note 51, § 57.14(a), at 10-70.
54. *Id.*
55. Scheduled losses are discussed *infra* at notes 59-63 and accompanying text.
56. LARSON, *supra* note 51, § 57.14(a), at 10-70.
57. *Id.* § 57.14(d), at 10-81 to 10-82.
58. *Id.*
59. *See, e.g.*, IND. CODE § 22-3-3-10 (Supp. 1992).
60. LARSON, *supra* note 51, § 57.14(c), at 10-78.
61. *Id.* § 57.14(d), at 10-82.

members, the back, internal organs, the voice mechanism, and the body as a whole.[62] In addition, schedules were extended to cover the partial loss of use of certain body members.[63]

Workers' compensation systems also began to pay scheduled benefits in a lump sum rather than over a period of weeks, months, or years as originally intended.[64] This practice further obfuscated the underlying presumption of scheduled benefits, which was that the benefit represented future wage loss.[65] Workers came to view the lump sum permanent partial benefit as payment for a lost member,[66] and worse, often spent the benefit as quickly as they received it thereby retaining no means to cover lost earning capacity.[67]

Actual wage loss systems also faded from existence because they failed to address non-economic injuries. Under an actual wage-loss system, workers who return to their prior employment at the same level of pay, and who nevertheless experience tremendous difficulties in their personal life, receive no compensation for the non-economic loss they have suffered.[68] In addition, the administrative cost of tracking an employee's future wages and accounting for changes in wage levels that are not caused by an injury also contributed to

---

62. *Id.* at 10-82 to 10-83.

63. *Id.* at 10-83.

64. *Id.*

65. *Id.* § 57.14(c), at 10-78.

66. Arthur Larson, *Basic Concepts & Objectives of Workmen's Compensation*, *in* 1 SUPPLEMENTAL STUDIES FOR THE NAT'L COMM'N ON STATE WORKMEN'S COMPENSATION LAWS 31, 33-34 (1973). Larson refutes any notion that an injured worker is entitled to permanent partial benefits due to his physical loss of function alone. This "school of thought," says Larson, came about as a "result of a combination of mistaken notions about the nature of schedule benefits." *Id.* at 33. Further, Larson states:

> This controversy is of prime importance in analyzing what is wrong with workmen's compensation today. The trend toward indiscriminate awards of small lump sums for small permanent partial injuries, the "give-the-poor-guy-something" attitude, and the perversion of lump-sum commutations from their original purpose to a facile way of getting a quick short-term disposition of a case satisfying to the immediate parties and their attorneys, adds up to a significant reason why the system is under criticism and in some instances is not doing the job it was intended to do.

Id. at 34.

67. *Id.*

68. LEWIS, *supra* note 38, at 56. Larson, however, rejects the inequity of this situation and asserts that "any argument based on genuine unfairness would have to assume that the injury was attributable to the fault of the employer, using fault in a genuine moral sense, rather than in some constructive legal sense." LARSON, *supra* note 66, at 34. In this regard, Larson further states, "It would be certainly morally unfair to force the employer to pay the employee for a purely physical loss that the employee has brought upon himself by his own negligence or other misconduct." *Id.*

Note, however, that failure to address non-economic losses attributable to an injury led the National Commission on State Workmen's Compensation Laws to recommend in its report that permanent partial benefits should include limited payments for permanent impairments. NAT'L COMM'N ON STATE WORKMEN'S COMPENSATION LAWS, *supra* note 9, at 69.

the system's demise.[69] In other words, compensable changes in wage levels had to be distinguished from non-compensable influences like inflation, the employee's motivation to work, and intentional under-employment.[70]

B. Pure Impairment

The second theory for paying permanent partial benefits is pure impairment. The focus of this theory is the medical consequences of an injury. The impairment benefit is thought of as a proxy for lost earning capacity or actual wage loss,[71] or a method of compensating injured workers for losses they experience in their personal life unrelated to work.[72] Pure impairment theory requires an injured worker's condition to be evaluated and rated for loss of physical function or ability to function. The rating is then converted into a benefit payable to the employee.

The attractiveness of this system is its simplicity. The only two questions to answer are: (1) Is there a permanent impairment?; and (2) What is the level of that impairment?[73] The opportunity for dispute is minimal, and as a result there is generally less litigation than in other systems.[74]

The major criticism of a pure impairment system is its failure to directly address the economic impact of an injury.[75] For example, a stenographer whose hand is amputated sustains a greater economic loss than a lawyer with the same injury because the stenographer is unlikely to return to his vocation, yet both are equally compensated under a pure impairment theory. In addition, there is no guarantee that the method of rating permanent impairment will be uniform in a pure impairment system. The rating criteria may differ from doctor to doctor, or even if the same criteria are used, there is an element of subjectivity in the methods in which the criteria are applied to the rating process.[76]

C. Earning Capacity Loss

Earning capacity loss, the third basic theory for payment of permanent partial benefits, attempts to combine actual physical impairment with its economic effects to determine the employee's potential loss of earning capacity.[77] Such considerations as the individual's age and education, the

---

69. LEWIS, *supra* note 38, at 56.
70. *Id.*
71. *See* John H. Lewis, *Indiana's Workers' Compensation Program: The Inexpensive Model?*, *in* JOHN BURTON'S WORKERS' COMPENSATION MONITOR, Sept.-Oct. 1991, at 5, 13.
72. NAT'L COMM'N ON STATE WORKMEN'S COMPENSATION LAWS, *supra* note 9, at 69.
73. LEWIS, *supra* note 38, at 54.
74. *Id.* at 55.
75. *Id.*
76. *Id. See also* notes 236-67 and accompanying text.
77. LEWIS, *supra* note 38, at 57.

impact of an injury on the employee's daily work activities, and the individual's work experience are considered in determining the permanent partial benefit.[78] In the previous example of the stenographer and the lawyer, an earning capacity loss system is more likely to provide the stenographer with a greater benefit because of his inability to return to his vocation.

Earning capacity loss systems also suffer from significant difficulties. Sorting out the multitude of factors that affect the benefit level is a cumbersome process, which typically produces prolonged settlement negotiations and, often, litigation.[79] Although experts claim that there is a movement to restore the centrality of the earning capacity loss theory,[80] the practical ability of this system to deliver benefits to those with the greatest economic loss has yet to be demonstrated.[81] Increased litigation tends to consume benefit dollars to the detriment of injured workers, and prolonged settlement negotiations keep needed benefits from injured workers.

III. Indiana's Permanent Partial Benefit

A. History

Generally speaking, Indiana's permanent partial benefit is based on pure impairment.[82] This has not always been the case. The 1915 Indiana Workmen's Compensation Act provided for permanent partial benefits based on disability, rather than impairment.[83] Recovery of the benefit was not based on "loss of a member, such as the loss of a limb, but . . . [on] the loss of earning capacity actually caused by the loss of the limb."[84] Scheduled losses were based on a presumption of diminished earning power extending through life.[85] Recovery for non-scheduled losses required proof of diminished earning capacity because the section of the 1915 Act dealing with such losses referred only to disability.[86]

In 1919 the Indiana General Assembly amended the section of the Act dealing with permanent partial benefits and replaced the word "disability" with

---

78. *Id.*

79. *See id.*

80. Larson, *supra* note 51, § 57.14, at 10-69.

81. *See* Lewis, *supra* note 38, at 57.

82. One important exception to this proposition is disfigurement. Disfigurement is compensable "[i]n all cases . . . which may impair the future usefulness or opportunities of the employee." Ind. Code § 22-3-3-10(b)(7) (Supp. 1992). "Usefulness" and "opportunities" have been construed to require proof that the disfigurement interfered with the claimant's ability to earn a living. *See* Campbell v. Kiser Corp. & Diecast, Inc., 208 N.E.2d 727, 729 (Ind. Ct. App. 1965).

83. Centlivre Beverage Co. v. Ross, 125 N.E. 220, 221 (Ind. Ct. App. 1919).

84. *Id.*

85. *Id.* (quoting *In re* Denton, 117 N.E. 520, 523 (1917)).

86. *Id.*

the word "impairment" in every instance where the resulting condition was permanent.[87] Shortly thereafter, the amended Act was construed to allow permanent partial benefits for "physical impairment" and not just diminution of earning power for both scheduled and non-scheduled losses.[88]

Arguably, after the amendment to the Act in 1919 replacing the word "disability" with the word "impairment" Indiana's permanent partial impairment benefits were considered a proxy for lost earning power. For example, in his treatise, *Workmen's Compensation Law of Indiana*, Dean Ben F. Small defined impairment as "either a partial or a total loss of the function of some part or parts of the body, or of the body as a whole, with the result that work opportunities are limited."[89] It is not clear, after the 1991 amendments to the Act by House Enrolled Act 1517,[90] that this statement remains an accurate description of Indiana's permanent partial benefit as it exists today.[91]

B. Indiana's Current Permanent Partial Benefit

Today, the payment of permanent partial benefits is governed by Indiana Code section 22-3-3-10.[92] Paragraph (a) covers complete losses, including amputations, blindness, enucleation of an eye, hearing, and the loss of testicles.[93] Paragraph (b) covers total loss of use, partial loss of use, permanent total disability, whole body impairment, and disfigurement.[94] Paragraph (c) covers the same losses as paragraphs (a) and (b), but provides a different method of computing the permanent partial benefit for accidents occurring on and after July 1, 1991.[95]

Indiana's impairment scheme under the Act can be roughly divided into scheduled and non-scheduled losses. Scheduled losses under the Act include total or partial impairment by amputation or otherwise to a finger, hand, arm,

---

87. *See* Edward Iron Works v. Thompson, 141 N.E. 530, 531-32 (Ind. Ct. App. 1923).

88. *Id.*

89. SMALL, *supra* note 16, § 9.5, at 247 (citations omitted).

90. *See supra* note 7.

91. The Report of the National Commission on State Workmen's Compensation Laws stated in its recommendation for reform of permanent partial benefits that impairment benefits might be appropriate in a worker's compensation system. NAT'L COMM'N ON STATE WORKMEN'S COMPENSATION LAWS, *supra* note 9, at 69. The Commission stated such benefits are justified because of loss incurred by a worker that is unrelated to lost remuneration. *Id.* Because the loss would have no relationship to wage loss, "there would be no necessity to link the value of the weekly benefits to the worker's own weekly wage." *Id.* Interestingly enough, one of the changes made to the Indiana Act in 1991 involved removing the connection between the average weekly wage and impairment benefit levels. *See infra* note 142 and accompanying text. Therefore, the benefit now more closely represents compensation for impairment rather than lost earning capacity.

92. IND. CODE § 22-3-3-10 (Supp. 1992).

93. *Id.* § 22-3-3-10(a).

94. *Id.* § 22-3-3-10(b).

95. *Id.* § 22-3-3-10(c).

toe, foot, leg, eye, hearing, and the complete loss of one or both testicles.[96] Also included under scheduled losses are double amputations (both hands or feet) or the total loss of sight of both eyes.[97] Non-scheduled losses covered by the Act involve impairment to the whole body including injuries to the back, pelvis, internal organs, psychological impairment, as well as any other impairment to the person not covered by the scheduled losses.[98]

Permanent partial benefits are paid to employees for impairment attributable to injuries arising out of and in the course of their employment.[99] The determination of impairment is completely distinct from the question of disability, and an employee may receive impairment benefits whether he is able to return to work or not. "'Impairment', as the word is utilized in the [Indiana] Workmen's Compensation Act, . . . connotes the injured employee's loss of physical function."[100] Disability on the other hand, refers to the injured employee's inability to work.[101]

An injury must be permanent and quiescent before permanent partial benefits are paid.[102] A finding of permanence and quiescence ensures that further medical benefits will not be required and prevents premature settlement or adjudication of claims. The permanence and quiescence of an injury are medical questions that must be established by expert testimony.[103] Consequently, the employee is not allowed to testify regarding this issue.[104] The assessment of impairment must be based on the functional loss present at the point when the employee's injury has become permanent and quiescent, and not based on a concern for future functional loss.[105]

The degree of impairment, in contrast to the permanence of the impairment, is a mixed question of lay and expert medical opinion. Thus, the employee may testify based on his experience and knowledge.[106] Evidence of lost earning capacity and disability is admissible to prove or disprove impairment of body function.[107] As a practical matter however, employee testimony is rarely relevant to the issue of impairment. Although statistics are not available, experience indicates that only a small percentage of claims

---

96. *Id.*

97. IND. CODE § 22-3-3-10(c)(2).

98. Andrew C. Charnstrom, *Words for Permanent Partial Impairment and Death in* WORKER'S COMPENSATION LAW 1988 12 (1988).

99. IND. CODE § 22-3-2-2 (Supp. 1992); *see supra* note 27.

100. Rork v. Szabo Foods, 439 N.E.2d 1338, 1342 (Ind. 1982) (citations omitted).

101. *Id.* at 1343 (citations omitted).

102. White v. Woolery Stone Co., 396 N.E.2d 137, 139 (Ind. Ct. App. 1979).

103. Kenwood Erection Co. v. Cowsert, 115 N.E.2d 507, 508 (Ind. Ct. App. 1953)

104. *Id.*

105. Sears Roebuck & Co. v. Murphy, 508 N.E.2d 825, 831 (Ind. Ct. App.), *reh'g denied*, 511 N.E.2d 515 (1987); *see infra* note 259.

106. *Kenwood Erection Co.*, 115 N.E.2d at 509.

107. SMALL, *supra* note 16, § 9.5, at 246 (citing Miers v. Standard Forgings Co., 69 N.E.2d 180 (Ind. Ct. App. 1946)).

proceed to a formal hearing on the issue of impairment where the employee's testimony would be heard.[108] Most permanent partial impairment benefits are paid by agreement between the employee and employer, or their lawyers,[109] subject to approval by the Worker's Compensation Board of Indiana (Board).[110] Thus, there is usually no opportunity for an injured worker to testify about the degree of impairment.

The Board, as trier of fact, is given broad discretion to determine the level of impairment.[111] The findings of the Board will not be disturbed on review unless, based upon substantial evidence in the record, reasonable men would reach a contrary conclusion.[112] The Board may choose from the impairment ratings presented to it or compromise the values.[113]

The calculation of the permanent partial impairment benefit is simple but differs slightly depending on the date of accident. For accidents occurring prior to July 1, 1991, the benefit is calculated by converting the impairment rating into a number of weeks of benefits derived from either the schedule in the statute for scheduled losses or as a percentage of 500 weeks for non-scheduled losses.[114] The value of each week of benefits is based on a percentage of the employee's average weekly wage.[115] The number of weeks of benefits is multiplied by the weekly benefit, credit for wage replacement benefits is taken if appropriate,[116] and the portion accrued as of the date of the accident is paid in a lump sum with the remaining portion paid weekly until exhausted.[117] For example: Suppose an employee sustains an injury that results in a ten percent permanent partial impairment to the left hand. Total loss of use of a hand is valued at 200 weeks, and ten percent of 200 weeks is twenty weeks. Assume that the employee was subject to the maximum compensation rate of $120 each week.[118] The permanent partial impairment benefit would be $120 multiplied by 20 weeks, or $2,400.

Until July 1, 1991, the maximum weekly wage for permanent partial benefits was $120.[119] This positioned Indiana at the low end of a nationwide scale for payment of permanent partial benefits.[120] Observers complained

---

108. Telephone Interview with Douglas Meagher, *supra* note 37.

109. According to a telephone and income replacement survey conducted by John Lewis, 22% of all permanent partial claims have attorney involvement. *See* Lewis, *supra* note 71, at 12.

110. Telephone Interview with Rita Bradley, Claims & Statistics Director, Worker's Compensation Board of Indiana (Sept. 14, 1993); *see* IND. CODE § 22-3-4-4 (Supp. 1992).

111. *See* Huffman v. United States Steel Corp., 268 N.E.2d 112, 113 (Ind. Ct. App. 1971).

112. Rork v. Szabo Foods, 439 N.E.2d 1338, 1341 (Ind. 1982) (citations omitted).

113. Wilson v. Betz Corp., 146 N.E.2d 570, 572 (Ind. Ct. App. 1957).

114. IND. CODE § 22-3-3-10(b)(6) (Supp. 1992).

115. IND. CODE § 22-3-3-10 (Supp. 1992).

116. *Id.*

117. *Id.*

118. *See* IND. CODE § 22-3-3-22 (Supp. 1992).

119. *Id.*

120. LEWIS, *supra* note 71, at 12.

that a low maximum benefit, coupled with impairment ratings determined by physicians, rendered Indiana's system deeply flawed and incapable of delivering appropriate benefits.[121] Throughout the late 1980s employee representatives pursued major changes in Indiana's workers' compensation system because of these and other perceived inequities.[122] These factors provided the impetus for Indiana to reform its workers' compensation system.

In 1990 Governor Evan Bayh appointed a Worker's Compensation Task Force (Task Force) to review the Indiana system and generate a comprehensive reform package to be introduced to the 1991 session of the Indiana General Assembly.[123] Governor Bayh's administration sought reform based on the belief that numerous amendments had caused the Act to stray from its original intent, which was "to provide an injured worker a certain source of compensation by eliminating the need to prove the employer's fault, while also providing the employer a relatively predictable level of financial exposure upon which it could seek insurance."[124] Bayh's administration sought to simplify the law thereby making it more accessible and understandable to the persons it was intended to serve.[125]

The Task Force was comprised of seven individuals from management, labor, and government.[126] Five committees were formed with appointees from business, labor, the legal and medical professions, and academia.[127] These committees included Agency Infrastructure and Data Management, Cost, Self-Insurance, Medical Care and Physical Rehabilitation, and Compliance and Safety Initiatives.[128]

Each committee was charged with analyzing specific workers' compensation issues and reporting their findings to the Task Force.[129] Governor Bayh also retained John H. Lewis to conduct an independent evaluation of the Indiana system and to provide information and assistance to the Task Force and the committees.[130] Permanent partial benefits were analyzed by the Task Force, which adopted, by a 6-0 vote, recommendations proposed by Lewis.[131]

---

121. *Id.*

122. *Id.* at 5 ("Most of their concerns centered around the need for additional benefit increases, but they also included other issues such as the choice-of-physician mechanism, occupational disease coverage, and the ability of the employer or insurance carrier to terminate temporary total disability benefits at will.").

123. Release from Governor Evan Bayh, Governor of Indiana, *New Governor's Task Force Announced* (June 22, 1990) (copy on file with the *Indiana Law Review*).

124. *Id.*

125. *Id.*

126. *Id.*

127. *Id.*

128. *Id.*

129. LEWIS, *supra* note 71, at 5.

130. *Id.*

131. GOVERNOR'S TASK FORCE ON WORKER'S COMPENSATION AND OCCUPATIONAL DISEASE LAWS REFORM, TASK FORCE RECOMMENDATIONS, 28 (Dec. 17, 1990).

These findings were presented to Governor Bayh in the December 17, 1990 *Task Force Recommendations Report* and later became law with some modification, by the Task Force, of the benefit levels which were suggested by Lewis.[132]

As part of his analysis of the Indiana workers' compensation system, Lewis conducted telephone and income replacement surveys[133] and conclud-

---

132. *See* IND. CODE § 22-3-3-10(c) (Supp. 1992). Although increasing benefit levels for the most severely injured, the benefit schedule passed by the Indiana General Assembly actually reduced benefits for persons with low impairment ratings as compared to the previous schedule.

> [A]s a result of the manner in which the phase-in [of increased benefits] is structured, those injured during the period July 1, 1991 through June 30, 1992 who have an average weekly wage of $200 or more and an impairment of thirty-five percent or less of the body will receive less than they would have received under the old law. The level of impairment affected by this benefit reduction will decrease during the phase-in, until it reaches ten percent on July 1, 1994.

LEWIS, *supra* note 71, at 16. The phase-in structure referred to by Lewis is provided below:

	Degrees	Dollars per Degree *of Impairment*
Current	1-100	$ 600
7/1/91	1-35	500
	36-50	900
	51-100	1,500
7/1/92	1-20	500
	21-35	800
	36-50	1,300
	51-100	1,700
7/1/93	1-10	500
	11-20	700
	21-35	1,000
	36-50	1,400
	51-100	1,700

Robert A. Fanning, *Worker's Compensation—Changes in Defense Practice in* WORKERS' COMPENSATION 1991 24 (1991).

133. *Lewis*, *supra* note 71, at 12. The findings of these studies included among other things: (1) "Ninety-seven percent of those in the telephone survey returned to work"; (2) 843 workers who were permanently injured in the first quarter of 1986 were doing better economically than a control group of workers randomly selected from the unemployment compensation program data base; (3) attorney involvement was substantially lower than most jurisdictions at only 22%; (4) two percent of those who were employed were not making as much as they were at the time of the injury; (5) "Sixty four percent felt that they had no work restrictions as a result of their injuries"; (6) "Eighty-three percent returned to the same employer, and approximately fifty percent of those were still with that employer four years later." (7) Thirteen percent were not working and 8.3% consider themselves disabled and unable to work; (8) "the only factor that could be identified as providing any correlation between injury factors and post-injury income loss was the level of

ed that the Indiana system, although simplistic and low cost, had begun to accomplish several meritorious goals.[134] A significant percentage of permanent partial benefits provided by the statute went to employees rather than attorney's fees and litigation costs.[135] Lewis also concluded that Indiana "returns a very high proportion of permanently injured workers to substantial employment."[136] To the extent that impairment benefits are intended to provide for future lost earning capacity or income, Lewis said:

> [I]t appears that there are relatively few permanent partial cases in Indiana that require income replacement assistance, or claimants who believe that their job abilities are any way affected by their injuries. For those who are suffering such losses, the impairment approach appears to be a reasonable way to predict who is likely to have the greatest [economic] need.[137]

The Indiana permanent partial benefit suffered from one major shortcoming according to Lewis. In his report to Governor Bayh, Lewis stressed that the benefit was one of the lowest in the nation.[138] To correct this situation, Lewis rejected solutions such as replacement of the pure impairment system with a pure wage-loss or loss of earning-capacity system because benefit levels would need to be increased significantly to enable such systems to deal with economic losses.[139] He also noted that there was little evidence to suggest that such an increase would go to the injured worker because litigation would most likely consume much of the increase.[140] Lewis concluded that if there was an interest in trying to more closely tie permanent disability benefits to economic loss, the existing permanent partial benefit system should be retained, but restructured, so that those who suffer the greatest impairment and who are most likely to suffer the greatest economic losses receive greater benefits.[141]

To accomplish the goal of directing more benefit dollars to those who are most likely to suffer economic loss, Lewis recommended two modifications of the then-existing system which were eventually adopted by the Indiana General Assembly. First, the connection was severed between benefit levels and average weekly wages.[142] Second, benefits were increased for higher

---

impairment, and the only predictor (but not a guarantee) of eventual income loss was a relatively high level of impairment." *Id.*

134. *Id.*
135. *Id.*
136. *Id.* at 17.
137. *Id.* at 13.
138. LEWIS, *supra* note 38, at 59.
139. *Id.* at 60.
140. *Id.*
141. *Id.*
142. *See* IND. CODE § 22-3-3-10(c). Lewis justified elimination of the average weekly

impairment ratings.[143] The new scheme of computing permanent partial impairment benefits retained the scheduled losses contained in the statute.[144] Rather than each scheduled loss representing a number of weeks of benefits, each loss was converted to degrees of impairment.[145] The degree-based schedule retained the relative weight assigned to each scheduled loss in the week-based schedule.[146] Whole body impairment, previously expressed as 500 weeks of loss, was expressed as 100 degrees of loss.[147] Each degree of impairment was assigned a dollar value with the greater values at the higher levels of impairment[148] and the benefit was calculated in a cumulative fashion.[149] Payment of the benefit under the new system, as amended by the Indiana General Assembly, is still made on the basis of the employee's average weekly wage, but is now paid at the employee's temporary total disability rate.[150]

In his report to Governor Bayh, Lewis also briefly addressed how impairment is evaluated and rated by physicians in Indiana. He touched upon various issues raised by the present practice, but made no specific recommendation for legislative action.[151] As a result, House Enrolled Act 1517 left the method of evaluating impairment unchanged. Part IV of this Note undertakes an examination of this issue and concludes that the Indiana General Assembly may have some additional work to do to fulfill Governor Bayh's mandate.[152]

---

wage as a basis for paying permanent partial benefits on his finding that 80% of permanent partial benefit recipients were receiving the maximum benefit under the old system. LEWIS, *supra* note 38, at 62. Thus, according to Lewis, Indiana might consider simply recognizing the fact that most workers are compensated irrespective of their average weekly wage and build the new system around this premise. One should note, however, that severing the connection between average weekly wages and benefit levels lessens the likelihood that economic loss is being compensated. If economic loss is the basis for the permanent partial benefit, it is illogical to compensate workers irrespective of their wages. *See supra* note 91.

Perhaps the average weekly wage scheme could have been retained with the maximum average weekly wage gradually increased for higher levels of impairment. This would have allowed only those with higher wages to collect higher benefits. Thus, the benefit would more closely compensate for economic loss.

143. *See* IND. CODE § 22-3-3-10(c).
144. *See id.*
145. *See id.*
146. *See id.*
147. *See id.* § 22-3-3-10(c)(11).
148. *See id.* § 22-3-3-10(d).
149. *See id.* § 22-3-3-10.
150. *See id.*
151. LEWIS, *supra* note 38, at 63-64.
152. *See supra* notes 123-25 and accompanying text.

IV. Evaluation of Permanent Partial Impairment in Indiana

A. The Role of the Guides to the Evaluation of Permanent Impairment

Generally speaking, Indiana does not prescribe under the Act, or by Board rule, a method for rating impairment.[153] Physicians, claims adjusters, and lawyers are given no legislative guidance regarding the content or extent of impairment evaluations. This is not to say that the practice of rating impairment is chaotic in Indiana.[154] In fact, most persons involved with workers' compensation claims in Indiana agree that the lion's share of permanent partial benefits are paid on the basis of an evaluation that relies in some measure on the *American Medical Association Guides to the Evaluation of Permanent Impairment.*[155]

The *Guides'* role in the Indiana workers' compensation system is to provide a physician, or other expert, with one method of evaluating and rating impairment. It is not the only impairment rating tool available to physicians[156] nor are its reporting and evaluation requirements always followed.[157] To a significant degree, the *Guides* plays only a supporting role in the system. Impairment ratings derived from the *Guides* are usually applied to the schedule in the Act,[158] or to other impairment rating tools developed by the Board, in order to derive a permanent partial impairment benefit.

The *Guides* originated from thirteen separate articles published from 1958 through 1970 in *The Journal of the American Medical Association.*[159] The first edition of the *Guides* was published in 1971 with the fourth and latest edition released in 1993.[160]

The fourth edition of the *Guides* consists of fifteen chapters, eleven of which relate to the evaluation of impairment for specific bodily systems. The first two chapters provide an overview of impairment evaluation and methods

---

153. Two exceptions include the Board's "bone loss" rule and "multiple digital loss" schedule. *See infra* notes 300-09 and accompanying text.

154. Lewis, *supra* note 38, at 63.

155. Guides, *supra* note 10. Interview with Douglas Meagher, *supra* note 37 (stating the *Guides* are the major source of impairment ratings in Indiana). *See also infra* note 210 (without exception, every health care professional interviewed for this Note used the *Guides* to some degree in evaluating impairment).

156. There are several alternative sources available to rate impairment. *See* Richard E. Johns, *Compensation and Impairment Rating Systems in the United States*, Journal of Disability, Oct. 1990, at 198-99.

157. *See infra* notes 197-233 and accompanying text.

158. The permanent partial impairment benefit for a non-scheduled loss is derived directly from the impairment rating. *See supra* note 98 and accompanying text.

159. American Medical Association, Guides to the Evaluation of Permanent Impairment xix (3rd ed. rev. 1991) [hereinafter Guides - 3rd ed.].

160. Guides, *supra* note 10, at 1.

for preparing records and reports. The final two chapters address psychological disorders and pain.

The purpose of the *Guides* is to provide "a standard framework and method of analysis through which physicians can evaluate, report on, and communicate information about the *impairments* of any human organ system."[161] Under the *Guides*, impairment and disability are defined in roughly the same manner as under Indiana law.[162] Impairment is defined in the *Guides* as the "deviation from normal in a body part or organ system and its functioning."[163] It is assessed by medical means and is a medical issue.[164] Disability, which the *Guides* is not intended to evaluate, is defined in the *Guides* as "an alteration of an individual's capacity to meet personal, social, or occupational demands, or statutory or regulatory requirements, because of an impairment."[165] Evaluating disability is "a nonmedical assessment of the degree to which an individual does or does not have the capacity to meet personal social, occupational, or other demands, or to meet statutory or regulatory requirements."[166]

---

161. *Id.* (emphasis added). The ability of any impairment evaluation system to accomplish this task is problematic. Indeed, the editors of the Guides acknowledge that

> the *Guides* does not and cannot provide answers about every type and degree of impairment, because of . . . [the inability of physicians to identify objective data on the normal functioning of some organ systems] and the infinite variety of human disease, and because the field of medicine and medical practice is characterized by constant change in understanding disease and its manifestations, diagnosis, and treatment.

Id. at 3.

162. *See supra* notes 100-01 and accompanying text.

163. GUIDES, *supra* note 10, at 1.

164. *Id.*

165. *Id.* at 2.

166. *Id.* at 317. The distinction in the *Guides* between impairment and disability appears fairly clear. However, consider the following passages from the *Guides*:

> In the *Guides*, impairments are defined as conditions that interfere with an individual's "activities of daily living," some of which are listed in the Glossary (p. 315). Activities of daily living include, but are not limited to, self-care and personal hygiene; eating and preparing food; communication, speaking, and writing; maintaining one's posture, standing, and sitting; caring for the home and personal finances; walking, traveling, and moving about; recreational and social activities; and *work activities.*

Id. at 1 (emphasis added).

Here, the distinction between disability and impairment is blurred beyond recognition. In fact, the two concepts appear to be intimately connected. Further, the foreword to the *Guides* expressly recognizes this connection and provides that "[p]ermanent impairments are evaluated in terms of how they affect the patient's daily activities, and this edition recognizes that one's occupation constitutes part of his or her daily activities." *Id.* at v-vi.

Interestingly, the *Guides* later disavows any connection between an impairment rating and disability: "The impairment estimate or rating is a simple number. Although it may have been derived from a well structured set of thorough observations, it does not convey any information about the person or the impact of the impairment on the person's capacity to meet personal, social, or occupational demands." *Id.* at 8.

The *Guides* is widely used in workers' compensation systems across the country. Its use is mandated by statute in some states; by policy, directive or regulation in others; and is used, although not mandated, in a few states.[167] The *Guides* is also the most highly regarded impairment rating tool available today.[168] Although widely used and highly regarded, the *Guides* is not without its critics. These criticisms, however, do not seriously detract from the *Guides*' usefulness as an impairment rating tool.

B. Criticisms of the Guides

1. Garcia v. Eagle Pass Auto Electric, Inc..—A recent decision by a Texas trial court in *Garcia v. Eagle Pass Auto Electric, Inc.*[169] incited critics of the *Guides* to challenge the validity of any system linking permanent partial benefits directly to impairment ratings based on the *Guides*.[170] After *Garcia*, one lawyer postulated that hundreds of thousands of injured workers who had been denied benefits in systems that use the *Guides* could have new claims and, that even the American Medical Association could face liability for the *Guides*' misuse.[171]

In *Garcia*, the plaintiffs, Garcia, the Texas AFL-CIO, and the Texas Legal Services Union, Local No. 2, sued Eagle Pass Auto Electric, the Texas Workers' Compensation Commission, and George Chapman in his capacity as executive director of the commission to obtain declaratory and injunctive relief.[172] Plaintiffs argued in part that the 1989 Texas Workers' Compensation Act's mandate that permanent partial benefits be paid to workers with

---

167. LARSON, *supra* note 51, § 54.11 at 10-492.80.

> In March, 1988, the U.S. Department of Labor published a table showing that use of the AMA Guide was mandated by statute in these states: Alaska, Florida, Georgia, Kentucky, Louisiana, Maryland, Montana, Nevada, New Hampshire, Oklahoma, Oregon, and Tennessee and by policy directive, or regulation in Arizona, Delaware, District of Columbia, Hawaii, Iowa, North Dakota, South Dakota, Vermont and Washington. In the following states it was used although not mandated: Alabama, Arkansas, Colorado, Idaho, Indiana, Massachusetts, Mississippi, Nebraska, New Mexico, Ohio, Rhode Island, South Carolina, Texas, Utah, and Wyoming. In the remaining states it was not used.

Id.

168. *See infra* notes 193-94 and accompanying text.

169. Garcia v. Eagle Pass Auto Elec., Inc., No. 90-11-10301 CV (Dist. Ct. Maverick Cnty., 365th Judicial Dist. of Texas, Dec. 31, 1990).

170. *See* Gary Taylor, *Workers' Comp Under Attack; AMA Guides Criticized*, NAT'L L.J., June 24, 1991, at 3.

171. *Id.*

172. Texas Workers' Compensation Comm'n v. Garcia, No. 04-91-00565-CV, 1993 WL 302683, at *1 (Tex. Ct. App. Aug. 11, 1993), *aff'g*, Garcia v. Eagle Pass Auto Elec., Inc., No. 90-11-10301-CV (Dist. Ct. Maverick Cnty, 365th Judicial Dist. of Texas, Dec. 31, 1990). Two plaintiffs, Fuller and Rivero, lacked standing and were dismissed from the suit. Eagle Pass Auto Electric presented no defense and did not appeal the judgment of the lower court.

permanent impairment as determined by the "'second printing . . . of the Guides to the Evaluation of Permanent Impairment, third edition, published by the American Medical Association . . .'" violated the open courts, due course of law, and equal protection provisions of the Texas Constitution.[173] The trial court agreed and found in pertinent part that the Act's use of the *Guides* as a basis for awarding compensation was unconstitutional because impairment ratings derived from the *Guides* do not have an "adequate scientific or medical foundation."[174] The court stated that the *Guides* was not a reasonable approach to impairment and was "dreadfully flawed" because it failed to cover illnesses such as chronic pain and mental trauma.[175] The trial court also proclaimed that impairment percentages generated by the *Guides* had no reasonable relationship to "true impairment."[176]

The Texas Court of Appeals affirmed the lower court but did not directly attack the *Guides*' ability to measure impairment as the trial court had done. Instead, the court of appeals criticized the Act's use of the *Guides*.[177]

The court reasoned in part that the Act's use of the *Guides* violated the open courts provision of the Texas Constitution because it constituted an unreasonable and arbitrary restriction of a cognizable common law cause of action when balanced against the purpose and basis of the workers' compensation statute.[178]

To establish the unreasonableness and arbitrariness of the Act's use of the *Guides*, the court of appeals highlighted the testimony of Dr. Smith, an editor

---

173. *Id.* at *12 (citation omitted). The constitutionality of the pure impairment system under the Indiana Constitution is beyond the scope of this Note. It should be noted, however, that the Indiana Worker's Compensation Act has employed a pure impairment approach since 1919 and that most constitutional challenges to the Act have failed. *See* Warren v. Indiana Tel. Co., 26 N.E.2d 399 (Ind. 1940) (Workmen's Compensation Act does not violate Indiana Constitutional provisions that courts shall be open, due course of law, right of trial by jury); Buckler v. Hilt, 200 N.E. 219 (Ind. 1936) (limit on attorney's fees under the Act to amount fixed by Board not violative of the Fourteenth Amendment of the United States Constitution); Collins v. Day, 604 N.E.2d 647 (Ind. Ct. App. 1993) (exclusion of agricultural workers from coverage does not violate equal protection or equal privileges and immunities guaranties); Eastham v. Whirlpool Corp., 524 N.E.2d 23 (Ind. Ct. App. 1988) (due process does not require that full board hold trial de novo after hearing before single member); McGinnis v. American Foundry Co., 149 N.E.2d 309 (Ind. Ct. App. 1958) (right to compensation barred by expiration of one year time limit under Occupational Diseases Act is not a violation of rights of due process and equal protection of law under Indiana Constitution). *But see* Portman v. Steveco, Inc., 453 N.E.2d 284 (Ind. Ct. App. 1983) (presumptive dependency statute relating to worker's compensation benefits violates equal protection provisions of Federal and Indiana Constitutions, to the extent that it employs gender-based discrimination).

174. Garcia v. Eagle Pass Auto Elec., Inc., No. 90-11-10301 CV at 12.

175. *Id.*

176. *Id.*

177. *Texas Workers' Compensation Comm'n*, 1993 WL 302683 at *24.

178. *Id.* at *16-*24.

of the *Guides*:

> Dr. Smith . . . testified that the Act utilizes the Guides in an arbitrary manner. He testified that the Guides "state very specifically that the impairment rating number is not to be put into a one-to-one correspondence with disability or any other concept under which money is to be paid." The Act uses the impairment rating from the Guides as a percentage factor in computing the amount to be paid, a method specifically disapproved by the Guides.[179]

While dissimilar to the trial court's assault on the *Guides*' ability to measure impairment, Dr. Smith's testimony appears to support an argument that it is inappropriate for any impairment system to directly convert a *Guides*-based impairment percentage into an impairment benefit. Interestingly, this argument finds further support, apart from the *Garcia* decision, in the latest edition of the *Guides* which provides in relevant part that "[i]t must be emphasized and clearly understood that impairment percentages derived according to the Guides criteria should not be used to make direct financial awards or direct estimates of disabilities."[180] Neither the court's basis for reaching this conclusion nor the apparent support for this conclusion in the most recent edition of the *Guides*, however, survives careful examination.

First, a key piece of evidence referred to by the court did not support Dr. Smith's testimony. After referring to Dr. Smith's testimony, the court quoted a passage from the *Guides* as evidence of their misuse. That passage provided:

> Each administrative or legal system that uses permanent impairment as a basis for disability rating needs to define its own process for translating knowledge of a medical condition into an estimate of the degree to which the individual's capacity to meet personal, social, or occupational demands, or to meet statutory or regulatory requirements, is limited by the impairment. We encourage each system not to make a "one-to-one" translation of impairment to disability, in essence creating a use of the Guides which was not intended.[181]

As Dr. Smith testified, this language from the *Guides* does advise against a one-to-one translation of impairment to disability. However, the language from the *Guides* does not specifically disapprove of using an impairment rating as a percentage factor in computing the amount to be paid, as Dr. Smith's testimony indicated and the court concluded.

Further, and quite separate from the *Garcia* court's unpersuasive analysis, there are at least three additional reasons to reject the argument that *Guides*-based impairment ratings should not be directly converted into impairment

---

179. *Id.* at *18.

180. GUIDES, *supra* note 10, at 5.

181. *Texas Workers' Compensation Comm'n*, 1993 WL 302683 at *23 (citation omitted).

benefits. First, evaluating impairment by itself provides no benefit to an injured worker. The whole purpose of evaluating impairment is to convert the results of the evaluation into a benefit. For the injured worker, a *Guides*-based impairment rating is worthless unless it is converted into a benefit. A prohibition against using a *Guides*-based impairment rating to directly determine a benefit would render the *Guides* useless in most, if not all, workers' compensation systems based on pure impairment. Surely, the editors did not have this in mind when they drafted the above language.

Second, whether a *Guides*-based impairment rating becomes part of a benefit calculation is within the province of legislators who develop benefit schemes and not the editors of the *Guides*.[182]

Third, the key language, "direct financial awards," from the latest edition of the *Guides* is subject to interpretation. Rather than a proscription against converting an impairment percentage into an impairment benefit in all systems, the language more likely proscribes such activity in those systems that base the impairment benefit on non-medical factors not measured by a *Guides*' based rating.[183] This interpretation is supported by the fact that the language at issue is immediately preceded by a discussion of the importance of distinguishing between medical and non-medical information in workers' compensation systems that compensate employees for impairment to their bodies.[184] Further, this interpretation is a less radical departure from the immediately preceding edition of the Guides which provided:

> Each administrative or legal system using permanent impairment as a basis for disability rating should define its own process for translating knowledge of a medical condition into an estimate of the degree to which the individual's capacity to meet personal, social, or occupational demands, or to meet statutory or regulatory requirements, is limited by the impairment.[185]

From this language, it is impossible to argue that the *Guides* proscribes using an impairment rating as a factor in calculating permanent partial benefits. Instead, this passage only proscribes the use of an impairment rating as the sole basis for a disability rating.

With respect to the purpose and basis for workers' compensation, the Texas Court of Appeals stated that the workers' compensation law is intended "'to provide adequate, equitable and timely benefits to injured workers, at a

---

182. "The editors who testified [in Garcia] were making a statement about workers' compensation, not medical information," said Attorney General Delmar Cain of Texas. Taylor, *supra* note 170, at 3. "They say they don't think you should plug [the GUIDES] into a workers' compensation system, but I think that's a legislative function." *Id.*

183. *See supra* notes 162-66 and accompanying text.

184. *See* GUIDES, *supra* note 10.

185. GUIDES-3RD ED., *supra* note 159, at 4.

reasonable cost to employers.'"[186] The historical basis for workers' compensation laws is the workers' relinquishment of the right to sue his employer for negligence in exchange for a system that compensates him at least partially for loss of earning capacity as a result of an industrial injury.[187] The court stated the Act's "pure impairment-based system is not an adequate or reasonable substitute for worker's common law negligence actions,"[188] and "for this reason the Act's use of the *Guides* violates . . . our constitution."[189]

The importance of these conclusions is paramount and they form the crux of what the court really found unacceptable about the Act.[190] The court's unwillingness to accept the legislature's adoption of a pure impairment system over a loss of earning capacity system preordained the Act's use of the *Guides* as unconstitutional. The inescapability of this conclusion derives from the fact that the *Guides* was never intended nor designed to measure lost earning capacity.[191] This apparent attempt to legislate from the bench[192] helps one to understand why the court failed to recognize significant testimony supportive of the *Guides*' use in a pure impairment system. For example, as the dissent noted, the court failed to recognize that three experts who testified at trial referred to the *Guides* as "state of the art" and several experts agreed that there was "no better written study or text for determining impairment."[193] Dr. Smith, cited by the majority to support its conclusions, testified that the *Guides* may be properly used to determine the extent and degree of impairment.[194] Further, The Report of the National Commission on State Workmen's Compensation Laws, referred to by the majority for the proposition that pure impairment is an improper basis for permanent partial benefits,[195] actually recommended incorporation of pure impairment as part of a permanent partial benefit scheme, and sanctioned the use of the *Guides* as a "rational" basis for evaluating an injury or disease.[196]

As is demonstrated above, and as the dissent concluded; Garcia was "the work of a court hell-bent on striking down the Act, not a court dispassionately reviewing a statute from a coordinate branch of government to see if it is

---

186. Texas Workers' Compensation Comm'n v. Garcia, No. 04-91-00565-CV, 1993 WL 302683 at *19 (Tex. Ct. App. Aug. 11, 1993) (citation omitted).

187. *Id.* at *22; *see* notes 23-26 and accompanying text.

188. *Texas Workers' Compensation Comm'n*, 1993 WL 302683 at 24.

189. *Id.*

190. *Id.* at *63 (Peoples, J. dissenting).

191. *See supra* notes 162-66 and accompanying text.

192. *Texas Workers' Compensation Comm'n*, 1993 WL 302683 at *55 (Peoples, J. dissenting).

193. *Id.* at *67.

194. *Id.*

195. *See id.* at *21-22.

196. NAT'L COMM'N ON STATE WORKMEN'S COMPENSATION LAWS, *supra* note 9, at 69.

rationally related to valid goals."[197] As such, any criticism of the *Guides* based on the *Garcia* decisions is misplaced and unpersuasive.

2. Improper Use.—Any contribution that the *Guides* makes to a permanent partial benefit system requires its proper use. The text is "complicated and technical"[198] and is intended to be used as an aid to the physician to "estimate" the extent of impairment of nearly any human organ system.[199] Unfortunately, evidence suggests that many physicians in Indiana fail to adhere to *Guides*' criteria in both evaluating and reporting impairment.

The *Guides* prescribes the components of a proper impairment evaluation. "[T]he first key to effecting an accurate impairment evaluation is a review of office and hospital records maintained by the physicians who have cared for the patient since the onset of the medical condition."[200] The second step is to show that the medical condition "has been present for a period of time, is stable, and is unlikely to change in future months in spite of treatment."[201] Third, the physician is advised to perform an impairment evaluation "to obtain enough clinical information to characterize [the injury] in accordance with the *Guides* requirements."[202] The final step is to compare the findings of the evaluation with the clinical information already available and determine whether the two sources of information are consistent.[203] If they are inconsistent, further evaluation should be performed in an attempt to satisfactorily resolve any discrepancies.[204]

Under the *Guides,* physicians are expected to complete a comprehensive report containing a description and analysis of every finding used to support a permanent partial impairment rating.[205] For example, the physician should include the following in his report: (1) a narrative history of the medical condition; (2) a description of the results of the most recent clinical evaluation; (3) a statement of plans for future treatment, rehabilitation, and reevaluation; (4) the diagnoses and clinical impressions; (5) an explanation of the impact of the medical condition on life activities; (6) the medical basis for concluding

---

197. *Texas Workers' Compensation Comm'n*, 1993 WL 302683 at *67 (Peoples, J. dissenting).

198. *Id.* at *15.

199. GUIDES, *supra* note 10, at 7.

200. *Id.* at 3. The text of the *Guides* provides:

> Such records include clinical notes, medical consultation reports, hospital records, admission and discharge summaries, notes on operations, pathology and laboratory test reports, and reports on special test and diagnostic procedures. Using multiple sources of information and attempting to ensure that the sources are objective can help eliminate bias, an error introduced by selecting or encouraging one outcome over another.

Id.

201. *Id.*

202. *Id.*

203. *Id.*

204. *Id.*

205. *Id.* at 10.

that the medical condition and patient's symptoms have or have not become stable; (7) a discussion about restrictions or accommodations with respect to daily activities or activities that are required to meet personal, social, and occupational demands; (8) explanation of each impairment value with reference to the applicable criteria of the *Guides*; and (9) a description of the specific clinical findings related to each impairment, with reference to how the findings relate to and compare with the criteria in the *Guides*.[206]

In practice, few of these reporting requirements are satisfied by most Indiana physicians.[207] Impairment evaluation reports typically contain only the name of the claimant, the date of accident, a brief description of the part of the body injured, and the impairment rating at the smallest organ level with translations to successively large organs up to the whole person.[208] Few, if any reports contain a narrative history of the medical condition, a description of the most recent clinical evaluation with reference to the *Guides*, a statement that the condition is stable, conclusions regarding restrictions or accommodations, or any of the other requirements in the *Guides*.[209]

Interviews with a variety of health care professionals actively involved in occupational medicine in Indiana also indicate that there is a significant degree of deviation from evaluation techniques prescribed by the *Guides*, and a wide range of evaluation methods employed by physicians.[210]

In whole or in part, impairment evaluations are sometimes delegated to nurses, physical therapists, occupational therapists, and other health-care professionals.[211] Some physicians repeat these evaluations while others rely exclusively on the findings of these professionals.[212] Clinical notes from physical therapy, occupational therapy, functional capacity evaluations, and clinical findings of other doctors are sometimes ignored by physicians.[213] Other physicians, with less confidence in evaluating impairment, rely heavily on this data to support their impairment estimates.[214] Occasionally, physicians performing independent medical evaluations to assess impairment do not have a patient's complete medical history, treatment records, or even

---

206. *Id.*

207. Telephone Interview with Shal Marie McPherson, Claims and Statistics, Worker's Compensation Board of Indiana (Nov. 10, 1993).

208. *Id.*

209. *Id.*

210. Telephone interviews were conducted with health care professionals in central Indiana specializing in orthopaedics, physiatry, hand surgery, occupational and physical therapy, and occupational medicine (Sept. 1993) (interview notes are available from the author) [hereinafter Telephone Interviews with Central Indiana Healthcare Professionals].

211. *Id.*

212. *Id.*

213. *Id.*

214. *Id.*

impairment evaluations performed by other physicians before rendering their opinion on impairment.[215]

There are several reasons why impairment evaluations and reports fail to meet the criteria in the *Guides,* none of which are directly attributable to the *Guides* itself.

One of the most significant reasons for deviation from the *Guides* is that the Board's agreement approval process for permanent partial impairment benefits does not require submission of a complete report based on the criteria prescribed by the *Guides.* Most permanent partial benefits are paid by agreement between the employer and the employee.[216] In the agreement process, the physician renders an impairment rating and the employer completes an agreement that delineates the portion of the body rated, the rating number, and the calculation of the permanent partial benefit.[217] The employee and employer both sign the agreement and submit it to the Board for approval.[218] The agreement must be accompanied by the medical report containing the impairment rating[219] and a waiver of the employee's right to obtain another impairment evaluation.

The Board employs a two-step agreement review process: (1) the agreement is checked to be sure that the proper part of the body was rated; and (2) the benefit is re-calculated to ensure that no computational errors were made.[220] If the proper part of the body was rated and the calculations are correct, the Board will approve the agreement.[221] The agreement is then returned to the employer who pays the permanent partial benefit. Other than checking to be sure the correct part of the body has been rated, there is no attempt to review the adequacy of the medical report submitted with the agreement, nor an attempt to review the adequacy of the medical evaluation.[222] Under these circumstances, even the most conclusive impairment reports are sufficient to obtain approval from the Board. Doctors may not be aware that impairment ratings are subject to such cursory review procedures, but this fact is certainly known to the insurance companies and employers who request these reports. This process provides little incentive to produce a report or conduct an evaluation that even approximates the *Guides*' requirements.

Some deviation from the *Guides* can also be traced to cost considerations and time pressures placed on doctors from insurance companies, employers,

---

215. *Id.*

216. Interview with Douglas Meagher, *supra* note 37. The agreement is usually consummated by completing an "Agreement to Compensation of Employee And Employer," State Form 1043 (R/S-88).

217. Telephone interview with Rita Bradley, *supra* note 110.

218. *Id.*

219. *Id.*

220. *Id.*

221. *Id.*

222. *Id.*

and lawyers. The cost of an evaluation that complies with criteria from the *Guides* can be as high as $500.00 and obtaining such a report can take anywhere from four to six weeks or longer.[223]

Another reason for deviation from the *Guides* is that some treating physicians disdain performing an impairment evaluation because it has very little to do with treating or rehabilitating a patient.[224] These doctors are more likely to deviate from the *Guides'* evaluation process.

The variety of methods used by physicians in evaluating impairment may also be caused by disparities in training and knowledge among physicians concerning impairment evaluations.[225] One Indiana physician who has received special training in performing impairment evaluations with the *Guides* said that "many doctors think they are using the *Guides* correctly but only a very small percentage actually do."[226]

In most instances, doctors receive no special training in medical school to perform impairment evaluations.[227] Some doctors are exposed to the process through their residency training.[228] The level of exposure in residency depends on the specialty of the doctor and the setting for the program.[229] For example, a doctor in an orthopaedic residency program located near a highly industrialized area might gain some experience in conducting impairment evaluations.[230] Conversely, the same resident in a university setting would be less likely to deal with occupational injuries and have less of an opportunity to gain experience in impairment evaluations.[231]

Once in practice, most doctors develop whatever impairment evaluation skills they may have through practical experience or educational programs and seminars.[232] Although the level of involvement in educational programs and seminars focusing on impairment evaluation skills is difficult to assess, this sort of activity does not appear to be having much of an impact on the quality of reporting and evaluation techniques used by many physicians. Perhaps more substantial and focused training is required. At least two organizations offer specialized training, information, and accreditation for evaluating

---

223. Telephone interviews with Central Indiana Healthcare Professionals, *supra* note 210.

224. Mark D. Sullivan, M.D. & John d. Loeser, M.D., *The Diagnosis of Disability Archives of Internal Med., Am. Med. Ass'n*, Sept. 1992, at 2 (available in LEXIS GENMED Library, ARIM File) (citations omitted) .

225. Telephone interview with Central Indiana Healthcare Professionals, *supra* note 210.

226. *Id.*

227. *Id.*

228. *Id.*

229. *Id.*

230. *Id.*

231. *Id.*

232. *Id.*

impairment.[233] Unfortunately, their role in the Indiana medical community is presently very limited.

Although, misuse of the *Guides* appears to be widespread, it is imperative to recognize that its causes are rooted in the way that the text is used and not in the text itself. Moreover, the causes of misuse are not intractable and simple measures could be taken to ensure that medical evaluations comply with *Guides*-based criteria. For example, the Board agreement review process could require that all medical reports conform to a standard format with reporting criteria that ensures complete and thorough impairment evaluations.[234] Standard reports could be easily scanned for completeness and the content of randomly selected reports could be completely evaluated for accuracy and correct evaluative methodology with little disruption of claims processing. This change would force insurance companies and employers to request more complete reports and evaluations from physicians. Additionally, the Board's power to reject inadequate evaluations would provide an incentive for physicians to develop their impairment evaluation skills. The Board might even go a step further and require that all physicians who perform impairment evaluations receive special training or accreditation.

3. Inequity of a Guides-based Rating.—An effective delivery system for permanent partial benefits must distribute benefits equitably. In order to be

---

233. The first organization is the Work Fitness & Disability Section ("WFDS") of the American College of Occupational & Environmental Medicine ("ACOEM"). WFDS was formed "to bring together those physician members of ACOEM who have a special interest in or who practice in the field of Work Fitness and or Disability [evaluation]." *Draft Bylaws of Section of Work Fitness and Disability Evaluation*, WORK FITNESS & DISABILITY EVALUATION, SECTION NEWSLETTER, AMERICAN COLLEGE OF OCCUPATIONAL & ENVIRONMENTAL MEDICINE, Nov.-Dec. 1992, at Attachment C. WFDS produces a newsletter and sponsors meetings, seminars, and other functions to promote the education of its members and to facilitate the exchange of information, problems, and solutions on disability and impairment evaluation issues. WFDS does not have an accreditation process and membership is somewhat limited in Indiana - the section has only ten members in its five-state central region. Telephone Interview with Carl Otten, M.D. (Oct. 12, 1993). There are 137 ACOEM members in Indiana. The central region consists of Illinois, Indiana, Wisconsin, Iowa, and Missouri.

The American Academy of Disability Evaluating Physicians ("AADEP") is another organization offering physicians an opportunity to develop and sharpen their impairment rating skills. AADEP was formed in 1987 and its primary objective is "to advance uniform standards in the evaluation of an individual who would have a disability." AMERICAN ACADEMY OF DISABILITY EVALUATING PHYSICIANS, AADEP MEMBERSHIP DIRECTORY, 1992-93, at 2. AADEP's goals are to: (1) "foster, develop, support and augment knowledge of the rolls and responsibilities of fully qualified doctors of medicine and osteopathy in the performance of disability evaluations"; (2) "[e]stablish qualifications and promote specialized training programs that lead to these qualifications in this specialized area of the practice of medicine"; and (3) "[r]ecognize the attainment and maintenance of the competency in the Disability Evaluation field through various levels of membership and certification." *Id.* AADEP divides membership into two classes: (1) Active Member, and (2) Fellow. Presently, five AADEP Fellows and one Active Member practice medicine in Indiana. *Id.* at 63, 92.

234. Such a form can be found in the *Guides*. *See* GUIDES, *supra* note 10, at 11-12.

equitable, impairment estimates under the *Guides* must be valid and reliable.[235] The *Guides* is a valid tool for measuring impairment if its rules produce appropriate and acceptable conclusions about impairment.[236] The *Guides* is a reliable tool if its results are reproducible.[237] In other words, if two physicians perform separate impairment evaluations of one worker, the evaluations should draw similar conclusions about the workers' physical functional ability.

Certain characteristics of the impairment evaluation process and the *Guides* impairment rating scheme may introduce inequities into the system that cause impairment ratings to be invalid and unreliable. For example, one facet of doctor behavior that affects the validity and reproducibility of impairment ratings is the concurrent roles that most doctors play—treating physician and rating physician.

In Indiana, most permanent partial impairment ratings are prepared by the physician who originally treated the worker. The *Guides* does not sanction this practice, nor does it disapprove of it. As a practical matter, a treating doctor is most often the rating doctor because it is more efficient for a doctor who is familiar with a patient's history to rate that patient's impairment. Combining treatment and rating functions in one doctor could cause impairment to be understated. An impairment rating is in some measure an assessment of the treating doctor's success in restoring functional ability.[238] Therefore, treating physicians who rate their own patients are to some extent evaluating their own work and may be less likely to complete an objective evaluation.

The *Guides* impairment rating scheme also appears to detract from the validity and reproducibility of a *Guides*-based impairment evaluation. Several areas of the *Guides* require the rating physician to assess "activities of daily living" as part of the impairment evaluation.[239] An impairment evaluation based on activities of daily living is less objective and reproducible than one that requires the use of devices or objective diagnostic tests to measure functional and anatomical impairment.[240] Which activities of daily living are relevant to a patient's impairment, and to what degree, must be determined by the rating physician and are likely to vary from practitioner to practitioner thereby diminishing the likelihood of valid and reproducible impairment ratings.

---

235. Ellen Smith Pryor, *Flawed Promises: A Critical Evaluation of the American Medical Association's Guides to the Evaluation of Permanent Impairment*, HARV. L. REV. 964, 973 (1990) (book review).

236. *Id.*

237. *Id.*

238. Telephone interviews with Central Indiana Healthcare Professionals, *supra* note 210.

239. *See infra* note 276.

240. Pryor, *supra* note 235, at 974.

Patient values and goals may also negate the validity and reproducibility of an impairment evaluation.[241] In assessing impairment, doctors face the daunting task of separating patients who cannot perform a physical function from those who will not perform a physical function.[242] *Guides*-based criteria for measuring impairment, such as range of motion, endurance, and strength, all depend upon what the patient cannot do as well as what the patient will not do. The task is to separate function that cannot be performed from function that will not be performed because the former is compensable while the latter is not.

Most employees probably do not embellish the magnitude of their injury by intentionally limiting function or malingering,[243] but there is a contingent of workers who are adept at this tactic of benefit maximization.[244] There are a variety of forces that contribute to such behavior. A worker might act this way because other workers' compensation benefits (i.e., temporary total or temporary partial benefits)[245] usually fail to fully compensate most workers for their disability from work. For example, the weekly wage replacement benefit is limited to sixty-six and two-thirds of the average weekly wage in Indiana[246] and the average weekly wage is subject to maximum levels contained in the Act.[247] Additionally, it is not uncommon for an injured worker to be angry with his employer for having been injured at work, especially when the injury was caused by an actual or perceived unsafe work practice. This worker may be prone to adopt behavior intended to draw attention to his situation or to make the company pay for his injury.

Job dissatisfaction caused by a lost promotion, conflicts with co-workers, disputes with managers and supervisors, monotonous work, or other forms of social distress are "regularly transformed into medical distress as pain. For example, among the strongest predictors of disabling back pain developing on the job are work satisfaction and social relations in the work place."[248] Here inability to function is caused by social factors rather than a physiological condition.

Inability to function that has little to do with physical injury or physical impairment has a definite impact on evaluations through self-limiting behavior during the impairment evaluation. There is another impact that is less obvious. Workers who behave this way may also indirectly inhibit their recovery of physical function through decreased effort during rehabilitation.[249]

---

241. Sullivan, *supra* note 224, at *7.
242. *Id.* at *6.
243. GUIDES, *supra* note 10, at 298.
244. Kerr, *supra* note 3, at A1.
245. *See supra* Part I.B.
246. IND. CODE § 22-3-3-8 (Supp. 1992).
247. IND. CODE § 22-3-3-22 (Supp. 1992).
248. Sullivan & Loeser, *supra* note 224, at *10.
249. *Id.* at *8.

One way of diminishing the impact of these problems on the validity and reproducibility of impairment evaluations using the *Guides* is to make an impairment rating as dependent on objective criteria as possible. The *Guides* does this in various areas by offering a doctor the option of assessing impairment on the basis of a diagnosis rather than a physical examination.[250] Impairment based on diagnosis focuses on objective clinical findings whereas impairment based on a physical examination incorporates subjective considerations that affect function. For example, diagnosis based impairment for a partial meniscectomy of the knee is ten percent permanent partial impairment to the leg.[251] Examination based impairment for such a condition might result in no permanent partial impairment if the knee functions normally after surgery.

Generally, the evaluating physician must determine whether diagnostic or examination criteria best describe the impairment of a specific patient.[252] The doctor might choose one over the other method based on prophylactic concerns,[253] whichever rating is greater,[254] whether the objective findings fit specific criteria,[255] or whether the doctor expects the patient to have greater impairment in the future.[256]

One problem with diagnosis based impairment is that the inference from objective criteria to functional deficit is "often spurious."[257] For example,

> [i]n back pain, typical roentgenographic findings such as degenerative disk disease correlate poorly with observed functional deficits or pain: 80% of individuals complaining of back pain have roentgenographically demonstrable lumbar disk disease, but so do 70% of asymptomatic adults. Reference to structural abnormalities increases the objectivity of disability rating without increasing their validity. Many parameters shape function besides structure.[258]

Another problem with diagnosis based impairment is that Indiana law does not require employers to pay permanent partial benefits unless there has been an actual loss of physical function.[259]

---

250. This is done for the lower extremity and the spine. For the spine the process is called a "diagnosis-related estimate" and for the lower extremity it is called a "diagnosis-based estimate." GUIDES, *supra* note 10, at 84-88, 94.

251. *Id.* at 83.

252. *Id.* at 84.

253. *Id.*

254. "For instance, a patient with a femoral neck fracture with nonunion, who requires one crutch, should be rated for use of the crutch or for the nonunion plus the range of motion restriction, whichever is greater." *Id.*

255. *Id.* at 94.

256. Telephone interviews with Central Indiana Healthcare Professionals, *supra* note 210.

257. Sullivan & Loeser, *supra* note 224, at *9.

258. *Id.*

259. In Sears Roebuck & Co. v. Murphy, 508 N.E.2d 825 (Ind. Ct. App. June 11, 1987)

Although diagnoses based impairment may not adequately address the inequities of a *Guides* based impairment evaluation, the *Guides* remains "the best written study or text for determining impairment."[260] Further, with the exception of incorporating activities of daily living, the inequities previously discussed do not find their genesis in the *Guides*' impairment rating scheme nor does there appear to be any impairment rating tool that is equipped to deal with factors like values and motivation. By the *Guides*' own admission, complete objectivity in evaluating impairment is impossible because the process involves not only objective and scientific data but also a physician's skill, training, experience, and judgment—all attributes that "compose part of the 'art' of medicine."[261] The *Guides'* impairment rating scheme was designed to increase objectivity and enhance equity by enabling "physicians to evaluate and report medical impairment in a standardized manner, so that reports from different observers are more likely to be comparable in content and completeness."[262] To increase objectivity, the *Guides* makes use of "medically accepted and scientifically derived data on normal functioning . . . " whenever possible.[263] When objective data on normal function was unavailable, the *Guides*' contributors "estimated the extent of impairments on the basis of their clinical experience, judgment, and consensus."[264] The subjective nature of a *Guides*-based impairment evaluation is important and sometimes overlooked by legislators who prescribe its use.[265] In fact, one critic argued that the *Guides*' claim of objectivity is "deeply flawed" because it "obscures" from the reader the normative decisions of its editors and of evaluating physicians.[266]

4. Obscured Normative Decisions.—The latest version of the *Guides*, like the preceding editions, incorporates the normative decisions of its editors and of evaluating physicians through its impairment rating scheme. In a review of

---

plaintiff Murphy injured his knee at work and submitted to surgical removal of a portion of the medial meniscus or internal fibro-cartilage of his knee joint. The treating physician estimated Murphy's impairment as five percent of the leg on the basis that Murphy had lost part of his medial meniscus and might have functional loss in the future. The Board awarded Murphy five percent permanent partial impairment and the Indiana Third District Court of Appeals reversed, holding that the mere loss of cartilage in a knee without more is not the kind of loss that is compensable in Indiana. Permanent partial impairment must not be based on a concern for future problems or the actual loss of a body structure. *Id.* It must be based on present functional loss. *Id.*

260. Texas Workers' Compensation Comm'n v. Garcia, No. 04-91-00565 CV, 1993 WL 302683, at *55 (Tex. Ct. App. Aug. 11, 1993) (Peoples, J. dissenting).

261. GUIDES, *supra* note 10, at 3.

262. *Id.* at 5.

263. *Id.* at 3.

264. *Id.*

265. Pryor, *supra* note 235, at 965.

266. *Id.* at 964-65. Pryor was examining the third edition of the Guides but her criticisms appear equally applicable to the fourth edition.

the third edition of the *Guides*, Ellen Smith Pryor concluded that those who prescribe the *Guides*' use must be aware of this fact and should not view the *Guides* as purely technical or medical in nature.[267]

Pryor first notes that impairment exists at both the organ and whole person level.[268] Measures of organ level impairment are based on comparisons between healthy and non-healthy appearance and function.[269] Measurement at the whole person level is based on the person's ability to perform activities of daily living.[270] Activities of daily living might include such things as self-care and personal hygiene; communication; sitting, lying down, and standing; walking and climbing stairs; driving, riding, and flying; grasping, lifting, tactile discrimination; having normal sexual function and participating in usual sexual activity; restful sleep; and having the ability to participate in group activities.[271]

According to Pryor, normative judgments enter the impairment evaluation through the *Guides* in at least two ways. First, at both the organ and whole person level, the selection of the activities to be measured, and the decision about what level of activity or ability will serve as the norm, introduces the editors' non-medical subjective considerations into the impairment rating. This occurs at the whole person level than the organ level where one might argue that there is a general consensus about normal function.[272]

Second, organ level impairment ratings are often expressed in terms of whole person impairment thereby incorporating normative characteristics into the rating at the organ level.[273] The *Guides* accomplishes this by providing physicians with tables that translate organ level impairments into whole person impairment, and encourages physicians to express all impairments in terms of the whole person.[274] The whole person impairment levels in these tables, concludes Pryor, "must rest on the authors' assessment of how the measured losses (e.g., range of motion loss) affect the person's ability to carry on activities of daily living."[275]

Several chapters of the *Guides* also expressly define impairment criteria in terms of the restrictions or limitations that impairments impose on a patient's ability to carry out activities of daily living.[276] This puts the

---

267. *Id.* at 968.
268. *Id.* at 967.
269. *Id.*
270. *Id.*
271. GUIDES, *supra* note 159, at 243.
272. Pryor, *supra* note 236, at 968
273. *Id.*
274. *Id.* at 971; GUIDES, *supra* note 10, at xviii ("The *Guides* continues to espouse the principles that all impairments affect the individual as a whole and that all impairments should be expressed as impairments of the 'whole person.'").
275. Pryor, *supra* note 235, at 971.
276. *See* GUIDES, *supra* note 10, at 141 (The Nervous System), 170 (The Cardiovascular

selection and weighing of activities of daily living in the hands of the physician. Thus, the physician's personal biases and assumptions concerning activities of daily living also become part of the impairment evaluation.[277] Even more significant, guidelines and examples of activities of daily living contained in the *Guides* also evidence a strain of gender bias that may influence an evaluator.[278]

Pryor's point is valid—it is important to appreciate the subjective nature of a *Guides'*—based impairment evaluation and the manner in which it is obscured from the reader. It is equally important to understand that certain aspects of Indiana's permanent partial benefit system reduce the practical importance of normative decisions by the *Guides'* editors and evaluating physicians and thereby diminish the importance of these concerns.

First, as discussed earlier, the permanent partial impairment benefit might be thought of as a proxy for lost earning capacity.[279] As such, the incorporation of normative factors from the *Guides*, or anywhere else, is absolutely inconsequential as long as the final benefit approximates a workers' lost earning capacity—something the Indiana system appears to accomplish.[280]

Second, for injuries at the organ level, benefits are most often paid for impairment to the organ and not on the basis of impairment to the whole person.[281] This is done to ensure that proper credit can be taken for previous injuries, and so that credit can be taken for injuries to the same organ in the future.[282] Therefore, the incorporation of normative considerations through translation of organ level impairment to whole person impairment is greatly diminished.

Third, the Indiana system does not rely solely on an impairment rating to determine the level of impairment. At a hearing, the authority to decide which activities of daily living are relevant to the level of impairment ultimately rests with the Board who must weigh the relative probative value of prooffered

---

System), 202 (The Hematopoietic System), 301 (Mental and Behavioral Disorders), 307 (Pain).

277. Pryor, *supra* note 235, at 969-71.

278. *Id.* at 969. The fourth edition of the *Guides* also contains examples indicating gender bias. *See, e.g.*, *Guides*, *supra* note 10, at 179 ("A 62-year- old woman . . . was able to care for her house and perform other activities without symptoms . . ."); *id.* at 183 ("A 52-year-old woman . . . had had increasing breathlessness during daily activities, such as climbing stairs, mopping, or cleaning."). *But see id.* at 182 ("A 35-year-old woman . . . avoided participation in sports at the advice of physicians.").

279. *See supra* notes 71-76 and accompanying text.

280. *See* LEWIS, *supra* note 71, at 13.

281. *See* IND. CODE § 22-3-3-10 (Supp. 1992).

282. *See* IND. CODE § 22-3-3-12 (1988). This provision reads:

> [I]f the permanent injury for which compensation is claimed, results only in the aggravation or increase of a previously sustained permanent injury or physical condition, . . . the board shall determine the extent of the previously sustained permanent injury . . . and shall award compensation only for that part of such injury . . . resulting from the subsequent permanent injury.

expert medical opinion and lay testimony regarding an injury's impact on activities of daily living. [283]

C. Mandating the Guides' Use

The criticisms analyzed in Part III.B do not, on balance, significantly diminish the *Guide*' usefulness in a pure impairment system like the Indiana system. Indeed, a compelling case can be made for Indiana to mandate the use of the *Guides* to rate permanent partial impairment.

1. State of the Art.—Most experts agree that there is "no better written study or text in determining impairment" [284] than the *Guides.* Its impairment rating methodology is thorough and comprehensive[285] and reflects the most current research and expertise in evaluating impairment.[286] In light of these facts, it is not surprising that the *Guides* is presently the most widely used impairment rating tool in workers' compensation systems across the country.[287] If the use of any impairment rating tool is to be mandated in Indiana, it should be the *Guides.*

2. Eliminate Needless Complexity.—The existence of multiple impairment rating tools in Indiana makes the present permanent partial benefit system needlessly complex. If Indiana were to mandate the use of the *Guides*, the system could be greatly simplified.

In most cases, an impairment rating is derived from the *Guides* and applied to the schedule in the Act.[288] Some finger injuries, however, are not rated using the *Guides*. The Board has promulgated a rule that automatically awards an employee thirty-three percent impairment of the finger for an injury causing loss of bone to the distal interphalangeal joint of a finger.[289] An impairment rating based on any other source, including the *Guides*, that fails to award at least a thirty-three percent impairment of the finger for such an injury, will be rejected by the Board.[290] Additionally, a single injury involving more than one finger on the same hand is assessed with only partial reference to the *Guides.* The Board has developed a multiple digital loss schedule that provides the minimum value at which permanent partial benefits for injuries to more than one finger on the same hand should be calculated.[291] The multiple digital loss schedule is intended to compensate such

---

283. *See supra* notes 110-12 and accompanying text.

284. Texas Workers' Compensation Comm'n v. Garcia, No. 04-91-00565 CV, 1993 WL 302683, at *55 (Tex. Ct. App. Aug. 11, 1993) (Peoples, J. dissenting).

285. *See supra* notes 200-06 and accompanying text.

286. Johns, *supra* note 156, at 198-99.

287. *See supra* note 167.

288. Telephone interview with Douglas Meagher, *supra* note 37.

289. Telephone interview with Rita Bradley, *supra* note 110.

290. *Id.*

291. Memorandum from the Worker's Compensation Board of Indiana, *Compensation Table*

injuries as an impairment to the arm below the elbow and is based, "to the closest degree possible," on the following formula: "1. Find the total value of the loss of the separate digital and phalange members. 2. Find the percentage of this value in relation to 40 degrees.[292] 3. Increase the total allowance of the separate values by this percentage."[293]

Application of a *Guides*-based impairment rating to the schedule in the Act adds an unnecessary step to the calculation of impairment. The values in the schedule were arbitrarily determined long ago[294] and have remained unchanged despite significant advances in the understanding of the relationship between specific injuries and the extent of impairment.[295] Additionally, the relative value of individual organs to whole body impairment in the *Guides* is inconsistent with the values assigned in the schedule[296] and superimposing the *Guides*-based impairment rating scheme on the schedule in the Act confounds the impairment rating. The schedule may have once "provide[d] a short cut to the determination of benefits to be paid,"[297] but it has outlived its usefulness with the development of impairment rating tools like the *Guides*.[298] Mandating the use of the *Guides* would allow Indiana to dispose of this archaic, arbitrary, and duplicative rating tool and thereby simplify the impairment rating process.

Similarly, the Board's bone loss rule adds a needless layer of complexity to the system and should be abandoned and replaced by the *Guides*. This rule was promulgated in large part to reduce disputes over impairment ratings.[299]

---

for Multiple Digital Loss to the Hand (undated) (on file with author).

292. 40 degrees represents 100% loss of use of the arm below the elbow. IND. CODE § 22-3-3-10(c)(1) (Supp. 1992).

293. Memorandum from the Worker's Compensation Board of Indiana, *supra* note 292. For example, "[l]oss of the first phalanges of the thumb and index finger would be computed under this formula as follows:

Value of the first phalange of the thumb = 6 degrees
Value of the first phalange of the index finger = 2.67 degrees
Total specific loss = 8.67 degrees
8.67 degrees = 21% of 40 degrees
21% of 8.7 degrees = 1.82 degrees
1.82 degrees plus the specific 8.7 degrees = 10.5 degrees." *Id.*

294. Centlivre Beverage Co. v. Ross, 125 N.E. 220, 221 (Ind. Ct. App. 1919) (The schedules in the Act "provide arbitrarily that for certain injuries there shall be awarded compensation for a certain period definitely fixed.").

295. NAT'L COMM'N ON STATE WORKMAN'S COMPENSATION LAWS, *supra* note 9, at 69.

296. For example, complete loss of use of a thumb is valued as 22% of the whole person in the *Guides*. *See* GUIDES, *supra* note 10, at 18-20. Under the Act, the thumb is worth 12% of the person. IND. CODE § 22-3-3-10(c)(1) (Supp. 1992). Complete loss of use of the leg in the *Guides* is worth 40% of the person. GUIDES, *supra* note 10, at 83. Under the Act, the same loss is worth 45% of the person. IND. CODE § 22-3-3-10(c)(1).

297. NAT'L COMM'N ON STATE WORKMEN'S COMPENSATION LAWS, *supra* note 9, at 69.

298. *Id.*

299. Telephone interview with Rita Bradley, *supra* note 110.

The *Guides* provides an adequate and complete method for determining impairment in such cases.[300] Few doctors know about the bone loss rule[301] and it produces a fair amount of confusion and delay in processing claims because, despite the rule, many ratings rely initially on criteria from the *Guides* or other sources.[302] Further, the rule does not measure true physical impairment and is inconsistent with judicial interpretations of the Act because it is based on diagnosis rather than an examination of impairment.[303] Under the *Guides*, approximately two-thirds of the distal interphalangeal joint must be amputated before impairment of the finger reaches thirty-three percent while, under the rule, any loss of bone yields the same rating.[304] Under the *Guides* impairment due to bone loss could be as low as two or three percent of the finger.[305]

The Board's multiple digit loss schedule could also be eliminated by mandating use of the *Guides*. Its values are arbitrary and as compared to *Guides* criteria, the schedule overstates impairment between ten and twenty percent depending on the combination of fingers lost.[306] Because most doctors are unfamiliar with its provisions, the multiple digital loss schedule also tends to delay the payment of benefits.

3. Enhance Equity and Reduce Potential for Litigation.—In most cases, the present system does not specify what tool must be used to rate impairment.[307] Physicians are free to use any tool or combination of tools they desire. Because each impairment rating tool employs its own impairment rating scheme, it is possible for employees with similar injuries to receive largely disparate impairment ratings. Mandating use of one tool, like the *Guides*, would greatly diminish this potential inequity and enhance the likelihood of employees receiving similar benefits for similar injuries.

Similarly, failure to require that all impairment ratings derive from one source makes comparisons between competing impairment ratings very difficult. For example, an employee might obtain an impairment rating from their doctor based on the outdated Disability Evaluation and Treatment of Compensable Injuries,[308] while the employer's physician might rate the impairment with the fourth edition of the *Guides*. Resolving a discrepancy between the two ratings is clearly a problematic task simply because the ratings are based on two different impairment rating methodologies. This

---

300. GUIDES, *supra* note 10, at 30.

301. Telephone interviews with Central Indiana Healthcare Professionals, *supra* note 210.

302. Telephone interview with Shal-Marie McPherson, *supra* note 207.

303. *See supra* note 260 and accompanying text.

304. *See* GUIDES, *supra* note 10, at 30; Memorandum from the Worker's Compensation Board of Indiana, *supra* note 291.

305. GUIDES, *supra* note 10, at 30.

306. *See* GUIDES, *supra* note 10, at 35.

307. *See supra* notes 152-54 and accompanying text.

308. *See* Johns, *supra* note 156, at 198-99.

difficulty is likely to prevent the parties from amicably resolving this issue thereby increasing the likelihood of litigation. The *Guides* was designed to make impairment ratings more comparable in content and completeness[309] and mandating its use would diminish the likelihood of litigation.

V. CONCLUSION

When the Indiana Act was amended in 1991, significant changes were made to the method of computing permanent partial benefits, but the method of rating and evaluating impairment was not modified.

The Guides to the Evaluation of Permanent Impairment is presently an important part of the Indiana permanent partial benefit system but it appears to be frequently misused. Other than this difficulty, which could be easily corrected by revising the Board's agreement review process, criticism of the *Guides* is largely unpersuasive. In fact, the *Guides* is a tool that appears to have been tailor-made for the Indiana workers' compensation system. Requiring that all impairment ratings be based on the *Guides* and eliminating all other impairment rating tools would simplify the present system, enhance equity, and move the Worker's Compensation Act of Indiana one step closer to Governor Bayh's worthy goal of making the system accessible and understandable to the persons it was intended to serve—Indiana's injured workers.

309. GUIDES, *supra* note 10, at 5.

Indiana Law Review

Volume 27 1994 Number 3

BOOK REVIEW

DOCTORS' CONFLICTS OF INTEREST (& ALTRUISM) IN THE UNITED STATES AND GREAT BRITAIN

FRANCES H. MILLER*

Review of Marc A. Rodwin, MEDICINE, MONEY & MORALS: PHYSICIANS' CONFLICTS OF INTEREST, Oxford University Press, New York (1993).

INTRODUCTION

Patients often react with anxiety, not to mention indignation, to the notion that physicians derive profits from the practice of medicine.[1] Could financial self-interest possibly sully their own doctors' advice? Professor Marc Rodwin's *Medicine, Money & Morals: Physicians' Conflicts of Interest*[2] answers that question in the affirmative, giving comprehensive chapter and verse to support his conclusion. When doctors have the dominant hand in directing spending for more than 14% of this nation's GNP, it would probably be naive to expect otherwise.[3] But whatever happened to the medical profession's traditional altruism and to its ethical obligation to avoid financial conflicts of interest?[4] And how much clinical judgment is distorted by

* Professor of Law, Boston University School of Law, and Professor of Public Health, Boston University School of Medicine. J.D., 1965, Boston University School of Law; B.A., 1960, Mount Holyoke College.

1. The modern debate over the role of profit-making in medicine was stimulated by the publication of Dr. Arnold S. Relman's influential article, *The New Medical-Industrial Complex*, 303 NEW ENG. J. MED. 963 (1980).

2. Oxford University Press (1993).

3. *See generally* E. Haavi Morreim, Ph.D., *Economic Disclosure and Economic Advocacy: New Duties in the Medical Standard of Care*, 12 J. LEGAL MED. 275 (1991).

4. The American Medical Association's Principles of Medical Ethics (1957) § 7, stated: "In the practice of medicine a physician should limit the source of his professional income to medical services actually rendered by him . . . . His fee should be commensurate with the services rendered . . . . He should neither pay nor receive a commission for the referral of patients. Drugs, remedies or appliances may be dispensed or supplied by the physician provided it is in the best interests of the patient."

incentives for physicians to realize secondary economic gain[5] through their patients' medical problems?

Professor Rodwin's impressively documented and detailed book analyzes both of those important questions, and advocates statutory reform to minimize conflicts of financial interest between doctor and patient, conflicts he sees as inevitable given the competitive structure of the technology-intensive United States health industry.[6] But does our health system encourage more self-interested professional conduct than can be observed in other countries? Do other payment schemes promote less conflicted and more altruistic physician behavior? Is guaranteed payment itself the core of the problem, since most patients lack financial incentives to question their doctors' recommendations (or lack thereof) for testing and treatment? Or is the real culprit the expensive technological advance of the past four decades, which opened up previously undreamed-of opportunities for making money from medicine?

This Review will explore those questions in preliminary fashion, with direct comparison between abuses in the United States Professor Rodwin so graphically illustrates, and the recent introduction of competitive forces to the United Kingdom's National Health Service.[7] Over the past few decades, the professional ethos of physicians in the U.K. (which adopted national health insurance in 1948) has seemed more focused on public service than has that of the U.S. medical profession.[8] Indeed, one of the best-known analyses of the interplay between economics and patient welfare, Professor Richard Titmuss' *The Gift Relationship: From Human Blood to Social Policy*,[9] presented a scathing critique of American commercialism in medicine alongside a paean to British altruism.[10]

---

5. Professor Rodwin's book focuses primarily on the conflicts engendered by opportunities for physicians to generate *secondary* income from their professional status. *See infra* text accompanying notes 23-27.

6. The weekly *AMA News*, for example, gives prominent and comprehensive coverage to issues affecting the economic well-being of its membership. For example, the front page headlines for the October 18, 1993, edition were: "Coming out of the blocks running: Mrs. Clinton starts legislative dash to reform"; "Employers aren't waiting; market clout forcing reform"; and "Beginning of the end for fee for service?" AM. MED. NEWS, Oct. 18, 1993, at 1.

7. *See generally* Patricia Day & Rudolf Klein, *Britain's Health Care Experiment*, 10 HEALTH AFFAIRS 39 (1991).

8. JOSEPH JACOB, DOCTORS AND RULES (1988) (doctors constitute a professional elite motivated by the morality of service rather than by economic reward).

9. RICHARD TITMUSS, THE GIFT RELATIONSHIP: FROM HUMAN BLOOD TO SOCIAL POLICY (1971).

10. Professor Titmuss compared the entrepreneurial U.S. approach to blood transfusion policy with the more altruistic British technique, in the pre-AIDS era. This landmark work documented that the U.S. practice of paying blood donors, either with money or with replacement transfusions, had corrosive effects on the quality and cost of blood for transfusion. In contrast, the U.K.'s blood collection policy depends almost solely on the willingness of donors to make "no-strings" gifts of blood. The book documented that British altruism generated a sufficient supply of higher quality blood, at far lower cost, than did the quid pro quo policy of U.S. collection

Perhaps the communitarian underpinnings of the budget-capped National Health Service (NHS) have been instrumental in generating less self-interested physician behavior. On the other hand, it may be that opportunities for U.K. doctors to advance personal over patient interests have simply been lacking because of payment mechanisms under socialized medicine. The recent British introduction of competition to the health sector provides a revealing account of physician behavior in response to changing economic incentives.[11]

Professor Rodwin begins *Medicine, Money and Morals* by defining the two major types of conflict of interest between physician and patient: those between the personal interests of doctor and patient, which are often financial (but need not be so[12]), and those which "divide a physician's loyalty between two or more patients or between a patient and a third party."[13] He also distinguishes mere conflicts from actual breaches of obligation.[14] Professor Rodwin then traces the U.S. medical profession's reaction to perceived conflicts over the course of the past century, demonstrating persuasively that organized medicine has concentrated as much on defending the economic well-being of physicians as it has on promoting the best interests of patients.[15]

The part of the book most troubling to those unfamiliar with modern conflicts of financial interest in American medicine is the section detailing current problems and institutional responses.[16] Professor Rodwin describes an astonishing array of incentives for United States doctors to advance their economic well-being by increasing or decreasing medical services. The dangers both types of incentives present for the quality of patient care are sobering.[17] Professor Rodwin then paints a disturbing picture about the inability of present law and policy to cope adequately with those dangers.

Medicine, Money & Morals could hardly be more timely in the mid-1990s, as the United States gropes determinedly for ways to control its exorbitant spending on medical services, to help finance universal access to health insurance. President Clinton obviously agrees with the regulatory thrust of the book; indeed, Professor Rodwin's work was instrumental in documenting the

---

schemes. *Cf.*, Robert Solow, *Blood and Thunder*, 80 YALE L.J. 1696 (1971).

11. For background, *see generally* Frances H. Miller, *Competition Law and Anticompetitive Professional Behaviour Affecting Health Care*, 55 MOD. L. REV. 453 (1992).

12. Non-financial conflicts of interest abound in the physician-patient relationship. *See, e.g.*, A. Zuger & S.H. Miles, *Physicians, AIDS and Occupational Risk: Historic Traditions and Ethical Obligations*, 258 JAMA 1924 (1987).

13. RODWIN, *supra* note 2, at 9.

14. *Id.*

15. *Id.* at 19-52. *See* J. BERLANT, PROFESSION AND MONOPOLY (1975).

16. RODWIN, *supra* note 2, at 55-175.

17. "[P]atients need to know that virtually every major study indicates that physicians who make referrals to medical facilities that they either own or have a financial interest in, recommend more (or more expensive) medical tests and procedures than do physicians without a financial interest." *Id.* at 215 (footnotes omitted).

need for reform. The administration's 1993 budget legislation has already endorsed Professor Rodwin's views by extending the federal Medicare anti-kickback prohibitions to cover services rendered under Medicaid.[18] It has also expanded significantly the list of proscribed self-referral activities.[19]

Thus, in the brief period since this work was published, Congress has been instrumental in accomplishing some of Professor Rodwin's recommendations: that is, by "recasting social issues as legal ones . . . [as] a prelude to addressing them effectively."[20] *Medicine, Money and Morals* concludes that the medical profession is either incapable of policing conflicts of interest itself, or unwilling to tackle the problem as forcefully as circumstances demand. Professor Rodwin sees increased and more finely tuned regulation as not only desirable, but as essential.

The White House plan for health sector reform announced in the fall of 1993 takes Professor Rodwin's basic point about the detrimental potential of financial conflicts seriously, and proposes an all-payer health care fraud and abuse enforcement program as part of its strategy to enact universal health insurance coverage. The plan would punish "the payment or receipt of any item of value as an inducement for referral of any type of health care business . . . ."[21] The proposed reforms would also end medical self-referrals by prohibiting "[p]ayment to an entity for any item or service . . . in which the physician ordering services has a financial relationship . . . ."[22] The Clinton administration clearly considers minimizing the possibilities for doctors to generate income from anything but their own services to be a key element in controlling overall health care costs. Eliminating this economic incentive to prescribe unnecessary services has beneficial implications for the quality of health care as well. At the most simplistic level, unneeded medical procedures can harm patients, and the money saved by eliminating them frees up resources to provide care for those who might derive real benefit from it.[23]

---

18. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, 107 Stat. 312 (1993), to be codified as 42 U.S.C.A. § 1395 nn (1993).

19. These "designated health services" (for which referral is proscribed when the physician has a financial relationship with the entity furnishing them) now include clinical laboratory services; physical and occupational therapy services; radiology or other diagnostic services; radiation therapy services; durable medical equipment; parenteral and enteral nutrients, equipment, and supplies; prosthetics, orthotics, and prosthetic devices; home health services; outpatient prescription drugs; and inpatient and outpatient services. *Id.* at 604.

20. RODWIN, *supra* note 2, at 246.

21. Health Security Act, Title V, subtitle E, §§ 5401-03; 5411.

22. Health Security Act, Title IV, subtitle A, Part S, § 4042.

23. Critics point out that the prohibitions could also sweep too broadly. In limited circumstances they might prevent doctors from prescribing needed care regardless of whether an actual conflict existed, simply because they stood to benefit financially. To deal with that possibility, the 1993 budget legislation makes an exception to its enumerated prohibitions for rural providers "if substantially all of the designated services . . . are furnished to individuals residing in such a rural area." 107 Stat. 312, at 598.

But is all this regulatory cat-and-mouse activity really necessary? Are conflicts of interest a peculiarly American problem, and does regulating perceived conflicts further undermine physicians' altruistic impulses? Could we structure our health care delivery system differently to make doctors less vulnerable to conflicts between their personal interests and the health needs of their dependent patients? A brief look at physician behavior under socialized medicine in the U.K., both before and after the 1991 introduction of competition to the National Health Service, may shed light on the answers to these questions.

I. WHY DO THINGS SEEM WORSE TODAY?

Until shortly before mid-twentieth century, physicians could provide surprisingly little in the way of effective medical treatment.[24] Ordinarily they could give their patients scarcely more than their own knowledge, skill and judgment, plus whatever compassion and empathy they could muster. Antibiotics and the modern wonder drugs were not yet available to curb surgical and other infections, so hospitals were sometimes extremely dangerous venues for sick people. The great technological advances which permit sophisticated diagnoses—and sometimes cures—in medicine were yet to be discovered.[25] Quite simply, there was not much physicians could *do* as healers that they did not do themselves. Scant opportunity existed for doctors to recommend medical tests or procedures which might generate an additional source of revenue for them. Most doctors' professional income was thus directly related to the services they actually performed. Moreover, many patients paid little for those services prior to the introduction of private health insurance during the depression era[26] and the more recent introduction of the Medicare and Medicaid programs.[27]

Even the simpler state of economic arrangements between doctor and patient that existed until well into this century was not entirely devoid of financial conflict of interest. Fee-for-service medicine, which was the overwhelmingly dominant mode of United States practice until the 1980s, entails inherent tension between a patient's legitimate medical needs and the physician's ability to increase income by delivering unnecessary medical

---

24. *Cf.* THOMAS MCKEOWN, THE ROLE OF MEDICINE: DREAM, MIRAGE OR NEMESIS? (1979). In the Foreword to *Medicine, Money & Morals*, at p. ix, Dr. Arnold Relman describes the American medical care system as "formerly a community-based social service . . . ." Arnold Relman, *Foreword* to RODWIN, *supra* note 2, at ix.

25. *See generally* PAUL STARR, THE SOCIAL TRANSFORMATION OF AMERICAN MEDICINE, ch. I (1982).

26. SYLVIA A. LAW, BLUE CROSS: WHAT WENT WRONG? (1974).

27. Medicare (42 U.S.C.A. § 1395 et seq. (West 1992 & Supp. 1993)) and Medicaid (42 U.S.C.A. § 1396 et seq. (West 1992 & Supp. 1993)) were enacted in 1965.

care.[28] The more often the patient sees the doctor, the more often the doctor gets paid.

Salaried medical practice, which has become much more prevalent in this country as pressures for managed care have increased, presents the opposite problem. Because income remains constant no matter what services physicians render, they can increase their effective rate of return by cutting back on patient treatment and maximizing their free time. Both financial reward structures tempt doctors to consider their own economic well-being in the context of ministering to their patients' medical needs. The personal financial reward is tied directly to the physician's own efforts.

Professor Rodwin acknowledges these conflicts associated with fee for service and salaried modes of practice. If doctors are to be compensated for their services at all, however, some form of economic conflict is inevitable.[29] Moreover, health insurers already utilize many managed care mechanisms[30] and other monitoring devices[31] to detect and discourage abuse arising from these basic compensation systems. Far more insidious, according to Rodwin, are the conflicts of interest engendered by opportunities for physicians to generate significant *secondary* profit from the diagnostic or therapeutic procedures they recommend their patients to undergo,[32] and by the divided loyalties created by some insurance arrangements.

The level of scientific uncertainty in medicine,[33] combined with the widespread availability of health insurance, has enhanced doctors' ability to dominate medical decision-making. Third party payment curtails patients' financial motivation to question medical advice, and information inequality between doctor and patient simply reinforces the passive patient role. Historically, third party payment has also encouraged doctors to disregard the

---

28. The market share for indemnity health insurance, which reimburses patients primarily for the amounts they pay for fee-for-service medical expenses, dropped precipitously from 95% of all private health insurance sold in 1982, to 45% a mere decade later. Harris Meyer, *Beginning of the End for Fee For Service?*, Oct. 18, 1993, AM. MED. NEWS at 1, 33.

29. ALBERT R. JONSEN, THE NEW MEDICINE AND THE OLD ETHICS (1990).

30. Frances H. Miller, *Vertical Restraints and Powerful Health Insurers: Exclusionary Conduct Masquerading as Managed Care?*, 51 LAW & CONTEMP. PROBS. 195, 199-207 (1988).

31. Timothy S. Jost, *Administrative Law Issues Involving the Medicare Utilization and Quality Control Peer Review Organization (PRO) Program: Analysis and Recommendations*, 50 OHIO ST. L.J. 1, 4-9 (1989).

32. For background, see Frances H. Miller, *Secondary Income from Recommended Treatment: Should Fiduciary Principles Constrain Physician Behavior? in* THE NEW HEALTH CARE FOR PROFIT: DOCTORS AND HOSPITALS IN A COMPETITIVE ENVIRONMENT 153 (Bradford H. Gray ed., 1983).

33. Greenfield, Nelson, Zubkoff, et al, *Variations in Resource Utilization Among Medical Specialties and Systems of Care: Results from the Medical Outcomes Study*, 267 JAMA 1624 (1992); Charles E. Ohelps, *The Methodologic Foundations of Studies of the Appropriateness of Medical Care*, 329 N. ENG. J. MED. 1241 (1993). *Cf.* LYNN PAYER, MEDICINE AND CULTURE (1988).

true costs of treatment, because the economic burden does not fall directly on either their patients or on them.[34] More recently, however, some have feared that the cost containment provisions of certain managed care systems may induce doctors to skimp on necessary treatment for their patients.[35]

Health insurance has generally diminished the necessity for physician altruism in delivering medical services, particularly since the 1965 introduction of Medicare and Medicaid, because insurance has pumped hundreds of billions of dollars into health care demand.[36] The societal need for doctors to deliver uncompensated care, or to cross-subsidize services for indigent patients with Robin Hood pricing, has thus been drastically reduced. Some contend that the guarantee of insurance payment may also have undermined the ethical norms of medicine, which once did a better job protecting patients from physicians' conflicts of financial interest.[37] If that general thesis is accurate, then the Clinton administration's proposed extension of coverage to all Americans will exacerbate conflict of interest difficulties, according to MEDICINE, MONEY & MORALS, unless comprehensive and well-crafted curbs on physician profiteering are enacted.

II. CONFLICTS OF PHYSICIAN INTEREST IN THE U.K.

The United Kingdom's health system provides a useful base of comparison for examining structural arrangements introducing new conflicts of financial interest to physician-patient relationships. Until well into the twentieth century, doctors in both the U.S. and the U.K. were compensated primarily on a fee-for-service basis, and professional practice and mores in the two countries were roughly similar.[38] As Professor Rodwin points out, when George Bernard Shaw was writing *The Doctor's Dilemma* in 1911,[39] he railed against what he considered the inherent folly of providing financial incentives for British doctors to perform individual medical acts: "That any sane nation, having observed that you could provide for the supply of bread by giving bakers a pecuniary interest in baking for you, should go on to give a surgeon a pecuniary interest in cutting off your leg, is enough to make you despair of

---

34. On the moral hazard problem in health insurance, see L. Frieberg & F.D. Scutchfield, *Insurance and the Demand for Hospital Care: An Examination of the Moral Hazard*, 13 INQUIRY 54 (1976).

35. Wickline v. State of California, 228 Cal. Rptr. 661 (Cal. Ct. App. 1986), *rev'd*, 727 P.2d 753 (Cal. 1986), *dismissed*, 741 P.2d 613 (Cal. 1987).

36. *See generally* THE NEW HEALTH CARE FOR PROFIT: DOCTORS AND HOSPITALS IN A COMPETITIVE ENVIRONMENT, *supra* note 32.

37. The American Medical Association's first Code of Ethics, adopted in 1847, suggests that economic conflict of interest issues concerned organized medicine more than a century ago. Ch. I, § 5.

38. *Cf.* Frances H. Miller, *The Doctor's Changing Role in Allocating U.S. and British Medical Services* (with Robert G. Lee), 18 LAW, MED. & HEALTH CARE, Nos. 1 & 2, at 69 (1990).

39. RODWIN, *supra* note 2, at 5.

political humanity."[40] Shaw championed government provision of medical services instead of private fee-for-service practice, which he found riddled with conflicts of interest for British physicians.

Since its inception in 1948, the U.K.'s National Health Service ("NHS") has constituted the world's most successful example of socialized medicine.[41] By every standard indicator of public health, the NHS has been spectacularly effective in providing good medical care for the entire population at a bargain price, notwithstanding perennial grousing about waiting lists for non-urgent services.[42] The NHS accomplishes this miracle with only 6.2% of GNP,[43] a fraction of what other western industrialized countries—most pointedly the United States—spend on the same endeavor.[44]

Approximately 32,000 general practitioners ("GPs") constitute the majority of NHS physicians, and they are independent contractors paid primarily on a capitation, rather than a fee-for-service, basis.[45] The NHS's more than 17,000 consultant-specialists are, by contrast, salaried, hospital-based doctors.[46] Until very recently, therefore, the major economic incentive created by either basic payment system was for NHS doctors to under-treat rather than to over-treat. Because the British government caps the total health service budget, neither GPs nor consultants had many opportunities to generate secondary income by ordering NHS patient care from third parties from whom they derived additional profits.[47] Thus a professional ethos oriented toward public service was consistent with economic reality.

In 1991 the National Health Service underwent radical re-structuring when the Conservative government created internal markets under the umbrella of socialized medicine.[48] Competitive forces were introduced to the NHS by

---

40. GEORGE BERNARD SHAW, THE DOCTOR'S DILEMMA: A TRAGEDY 9 (Penguin Books 1987) (1911).

41. *See generally* RUDOLF KLEIN, THE POLITICS OF THE NATIONAL HEALTH SERVICE (1983).

42. *See, e.g.*, George J. Scheiber, Jean-Pierre Poullier & Leslie M. Greenwald, *U.S. Health Expenditure Performance: An International Comparison and Data Update*, 13 HEALTH CARE FIN. REV. No. 4, 1, 53, 55, 65, 67 (1992).

43. *Id.* at 4.

44. More than 14% of GNP is currently spent on the U.S. health sector. *Cf.* Uwe E. Reinhardt, Ph.D., *Regulated Fees or Regulated Competition? Implications for Young Physicians*, 269 JAMA 1709 (1993).

45. *See, e.g.*, U.K. Dep't of Health, TERMS OF SERVICE FOR DOCTORS IN GENERAL PRACTICE, paras 32-34 (Feb. 1991).

46. Karen Bloor & Alan Maynard, *Rewarding Excellence? Consultants' Distinction Awards and the Need for Reform*, UNIVERSITY OF YORK CENTRE FOR HEALTH ECON. HEALTH ECON. CONSORTIUM 100 (1992).

47. NHS physicians are, however, permitted to engage in private practice to a limited extent. Private practice is conducted primarily on a fee-for-service basis in the U.K. *See* Monopolies and Mergers Commission, *Private Medical Services Monopoly Inquiry*, App. C, Private Healthcare (July 1993).

48. National Health Service and Community Care Act, 1990, ch. 19.

separating the government's historic purchasing function from its role as provider of health care.[49] Two new categories of surrogate purchasers forced hospitals and their specialist consultants to compete for contracts to provide patient care, in an effort to stimulate more efficient delivery of NHS services.[50] These reforms presented an unusual opportunity to observe the extent to which changed economic incentives can influence physicians' actions. Most significantly for purposes of examining physician conflicts of interest, the reforms now permit those GPs having a critical mass of patients on their lists[51] to control substantial budgets for the non-urgent specialist care required by their charges.[52] These GP-fundholders in effect function as mini-HMOs, striking individualized bargains with hospitals and consultants for the sophisticated services their patients require, but the GPs themselves do not provide.

To induce these GPs to become active instruments of competition among hospitals and consultants, the government permits fundholders to plow back money "saved" from their budgets through astute contracting to improve the amenities and other services of their own practices. Fundholders cannot pocket the savings directly, but they are allowed to augment their economic status collaterally with the fruits of their bargaining for more sophisticated patient medical needs. Practices upgraded as a by-product of budgetary economies become more attractive to current and potential fundholder patients, who can usually gain access to specialist and hospital care only through gatekeeper-GPs.[53] Significant practice improvements, in addition to faster and higher quality service when that is the outcome of contracting, improve fundholders' competitive position vis-a-vis all other GPs, with whom they must vie for portions of the fixed capitation pie. These capitation payments comprise the primary source of income for all GPs, fundholding or not.

How did GP-fundholders react to these restructured economic incentives? In most cases, they responded in time-honored profit-maximizing fashion. Not

---

49. For a more detailed description of the purchaser-provider split, *see* Miller, *supra* note 11, at 458-63.

50. District Health Authorities purchase specialist and non-urgent hospital care for the patients of non-fundholding general practitioners, while fundholding GPs purchase such care directly.

51. Those group practices serving at least 7,000 enrolled patients were permitted to become fundholders.

52. *See* Miller, *supra* note 11, at 460. Local District Health Authorities purchase hospital and consultant services for the patients of non-fundholding GPs.

53. The General Medical Council, which licenses U.K. physicians, states, "a specialist should not usually accept a patient without reference from the patient's general practitioner. If the specialist does decide to accept a patient without such a reference, the specialist has the duty immediately to inform the . . . [GP] of his findings and recommendations *before* embarking on treatment. . . ." [emphasis added] PROFESSIONAL CONDUCT AND DISCIPLINE: FITNESS TO PRACTICE 22 (1991). The British Medical Association strikes the same theme. *Philosophy and Practice of Medical Ethics* 13-14 (1988).

only did many of them raise the quality of patient care by driving bargains with hospitals for shorter waiting periods and more user-friendly service, but they innovated in other ways as well.[54] For example, some fundholders hired hospital-based NHS consultants directly—but in the consultants' private practice rather than their NHS capacity—to conduct specialty clinics on GP-fundholder premises.[55]

This relieved fundholder patients of the necessity to queue for NHS consultant appointments, often with the very same specialists who were now perfectly willing to see them more expeditiously while wearing private practice hats. These specialists thus responded to financial incentives permitted by the reforms exactly as economists would predict—in self-interested fashion—notwithstanding a more altruistic public articulation of professional duty. Moreover, fundholder patients requiring hospital services can now gain places on NHS waiting lists earlier, because a specialist examines them sooner than if they had to wait for a regular NHS consultant appointment.[56] Fundholders thus use NHS funds to purchase *private* consultant services for their NHS patients, who then get scheduled for NHS hospital treatment far more quickly than would have been possible without the intervening private consultation. The irony is that private market services have effectively improved the efficiency of publicly-financed health care.

Before long, some GP-fundholders latched onto the idea of forming private companies to supply ancillary services to their own practices, paid for from the fundholding budgets that they themselves controlled. Thus, some British GPs began to capitalize on the possibility of generating secondary income from the treatments they recommended for their patients by becoming shareholders in the companies furnishing those very services. In essence, these entrepreneurial fundholders responded to changed economic incentives by strategically altering their business arrangements to increase personal income; some of them are reported to have reaped a "windfall."[57] Little empirical data exists on whether patients were deprived of necessary care when these fundholder surpluses were generated, but preliminary evidence indicates that they were not. The government may simply have set fundholding budgets at too generous a level initially, in order to stimulate sufficient GP enthusiasm for fundholding to give the reforms momentum.

The British government responded to the clash of economic interest it had set in motion not by tinkering with the economic incentives, but by regulating

---

54. *See generally* Howard Glennerster et al., *A Foothold for Fundholding*, 12 KING'S FUND INSTITUTE (1992).

55. P. Pallot, *GPs Hire Specialist Help*, THE DAILY TELEGRAPH, May 16, 1991, at 2.

56. John Willman, *The Doctors' Dilemma—John Willman Takes the Pulse of the Changing U.K. General Practitioner Service*, FINANCIAL TIMES (LONDON), Mar. 31, 1992, at 15.

57. Alan Pike, *Government May Curb Spread of GPs Companies*, FINANCIAL TIMES (London), Dec. 10, 1992, at 8.

the conflicts. In other words, having adopted competition principles as a successful stimulus to efficiency, at least preliminarily, the NHS then resorted to regulation to contain the conflicts fanned by the newly competitive environment. As of April 1, 1993, the NHS no longer approves contracts with private companies providing health care if GP-fundholders receive direct or indirect payments for treatment the company delivers to fundholder patients.[58] This sounds very much like the prohibitions on self-referral which President Clinton proposes for all payors in the context of current United States health sector reform.[59] It also signals that the market forces unleashed in the U.K. in 1991 have been seductive enough to undermine the allegedly higher service ethos of at least some British physicians.

III. CONCLUSION

What do we learn from this brief examination of comparative economic incentive systems in health care? What does it tell us about medicine, money and morals? First and foremost, it confirms what most of us instinctively suspect anyway: that Professor Rodwin's evidence and analysis are basically correct. *Medicine, Money & Morals*, and the impact of competitive forces introduced to the U.K.'s National Health Service in 1991, both illustrate dramatically that economic self-interest exerts a powerfully seductive influence on professional behavior. It would thus be unwise to rely on professional self-restraint to forestall abuse, regardless of the articulated professional ethos.

Health policy planners and legislators should therefore pay attention to what Professor Rodwin suggests. They should analyze the economic incentives generated by physician payment systems meticulously, particularly when those payment mechanisms are mandated by government. If we are to embrace the principle of universal health insurance coverage, yet avoid investing massive new resources in the health sector, reform must be structured to minimize the potential for excessive private gain at the expense of cost-effective medical care. Professor Rodwin reminds us that money talks to American physicians, as it does to their British counterparts. We must be very careful about the message it sends.

---

58. HEALTH CARE DIRECTORATE, NAT'L HEALTH SERVICE, HSG(93)14, GP FUND-HOLDING PRACTICES: THE PROVISION OF SECONDARY CARE, Annex. A, 5 (1993).

59. *See supra* note 22 and accompanying text.